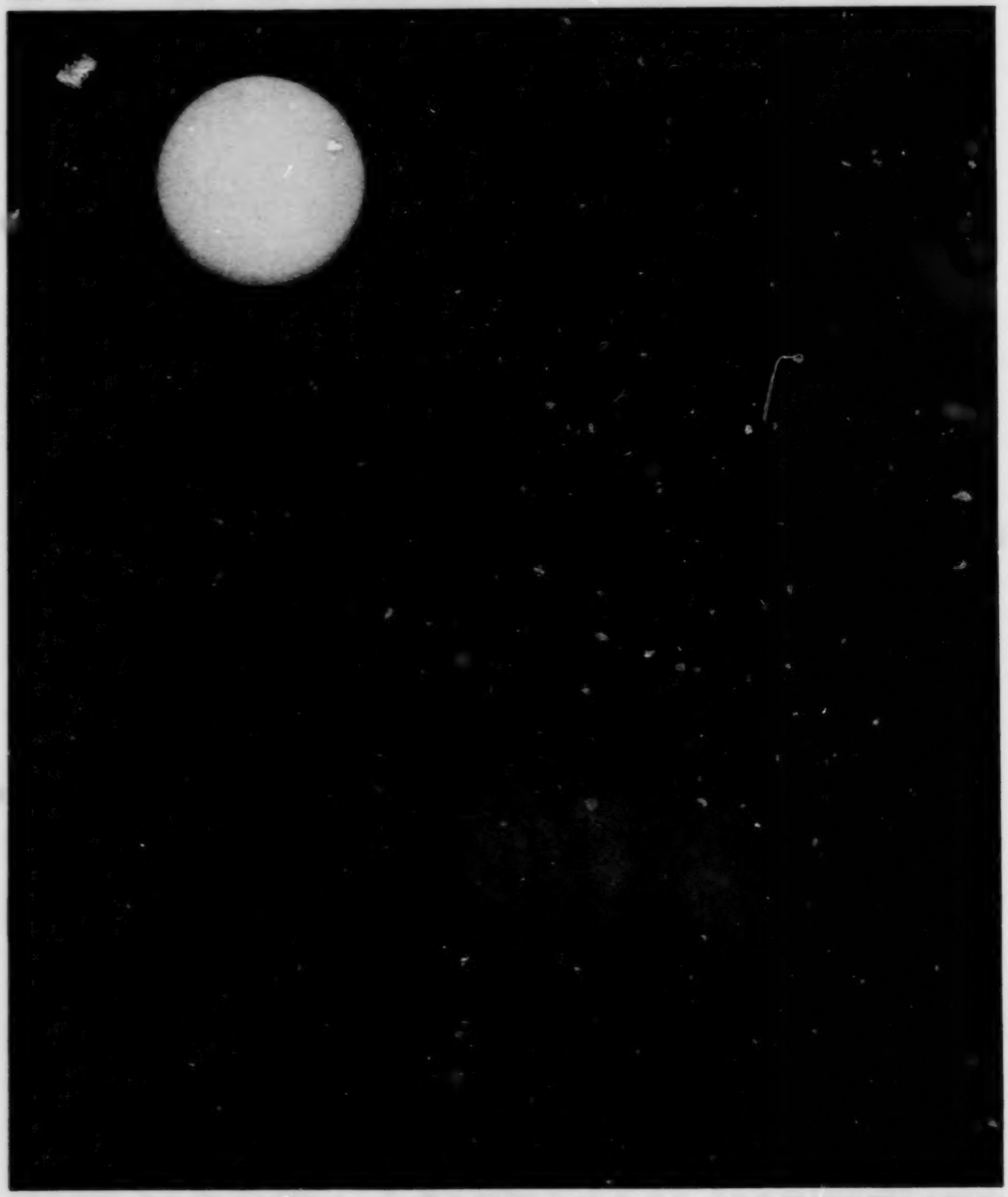
JAPAN'S RELATIONS WITH NORTH AMERICA

THE NEW PACIFIC INTERFACE



THE NORTH AMERICAN INSTITUTE

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Japan's Relations with North America: The New Pacific Interface

Japan's Relations with North America:
The New Pacific Interface

Edited by
Richard A. Matthew and K. Lorne Brownsey

The North American Institute
in association with
The Institute for Research on Public Policy

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Foreword

When it was approached by the North American Institute (NAMI) to help organize its July 13-15, 1990 meeting in Vancouver and to publish the proceedings volume from that gathering, the Institute for Research on Public Policy responded with enthusiasm. The focus of the July meeting—Japan's relations with an increasingly interdependent North America—was viewed as a natural follow-up to much of the Institute's recent work. The importance of trans-Pacific economic and trade relations to Canada and North America; the need for regional trade initiatives to complement the multilateral trading system; and perhaps most important, the need for dialogue to enhance understanding and appreciation of cultural differences and norms as a basis for sound relations between countries, are all themes that have emerged from recent Institute work on trading systems and the Asia-Pacific region. They are also important components of the NAMI agenda.

Despite the technologically impressive communications tools of our times, individuals and nations all too frequently fail to communicate effectively because of inadequate knowledge of each other. In an era of escalating global interdependence, such miscommunication can have profound implications. If we hope collectively to solve the world's problems of deteriorating ecosystems, massive underdevelopment in the Third World and rancorous trade relations (to name but a few), we must find ways to talk *with* our neighbors, rather than *at* them or *by* them.

By bringing together analysts, businesspeople and policy practitioners from Mexico, the United States, Canada and Japan, NAMI provided a bridge across which information and ideas were exchanged on a wide spectrum of shared concerns and problems. On specific issues such as the nature of the underlying forces driving the Japanese economy, the international responsibilities of superpowers such as the United States and Japan, the role of Japanese trade and investment in North America, North-South relations, and the viability of a Mexico-

U.S. free trade agreement—as well as Canadian involvement in it—perspectives from the four countries led, if not to a convergence of views, at least to a greater understanding and tolerance of differences.

I would like to thank NAMI's President, Susan Herter, as well as the three co-convenors of the meeting, Mason Willrich, Jesus Silva-Herzog and Jack Austin, for involving IRPP in this exciting initiative. On behalf of NAMI, I would also like to acknowledge the generous support for the meeting provided by the CRB Foundation, Canadian Airlines International, Westcoast Energy Inc., Swinton and Company, and Merit Kitchens, and the British Columbia Government for its support of this publication.

Rod Dobell
President
November 1990

Avant-propos

Lorsque le NAMI (North American Institute—Institut Nord-Américain) lui a demandé de participer à l'organisation de sa rencontre de Vancouver du 13 au 15 juillet 1990 et d'en publier les comptes rendus, l'Institut de recherches politiques a répondu avec enthousiasme. Ladite rencontre portait principalement sur les rapports entre le Japon et une Amérique du Nord de plus en plus interdépendante, et elle constituait la suite logique à un grand nombre de recherches récentes entreprises par l'Institut : l'importance des relations économiques et commerciales trans-pacifiques pour le Canada et l'Amérique du Nord, le besoin d'initiatives commerciales régionales pour renforcer le système commercial multilatéral, et ce qui est le plus important peut-être, la nécessité d'établir un dialogue visant à améliorer la compréhension et l'appréciation des différences culturelles et des normes, de manière à créer un climat de relations solides entre les différents pays. Tous ces thèmes ont déjà été étudiés par les chercheurs de l'Institut, dans le cadre des recherches consacrées aux systèmes commerciaux et à la région de l'Asie du Pacifique. Ce sont également des composantes importantes du programme de travail du NAMI.

Malgré les outils de communication remarquables dont nous disposons actuellement, les individus et les pays ont souvent du mal à communiquer entre eux de façon efficace, et ce parce qu'ils se connaissent mal. À l'ère d'une interdépendance globale accélérée, un tel manque de communication peut avoir des conséquences graves. Si nous espérons résoudre collectivement les problèmes mondiaux (par exemple la détérioration des écosystèmes, le sous-développement massif dans le Tiers-Monde et les relations commerciales acrimonieuses, pour n'en citer que quelques-uns), nous devrons trouver les moyens de parler *avec* nos voisins, plutôt que de parler *contre* eux ou *par* eux.

En réunissant des analystes, des gens d'affaires et des politiciens en provenance du Mexique, des États-Unis, du Canada et du Japon, le NAMI a permis de constituer un forum susceptible de faciliter les échanges d'informations et d'idées sur toute une variété d'intérêts et de problèmes communs. Sur des questions précises telles que la nature des forces sous-jacentes responsables du dynamisme de l'économie japonaise, les responsabilités internationales des super-puissances comme les États-Unis et le Japon, le rôle du commerce et des investissements japonais en Amérique du Nord, les relations Nord-Sud et la viabilité d'un accord de libre-echange entre le Mexique et les États-Unis (aussi bien que la participation du Canada à cet accord), les points de vue présentés par les quatre pays ont mené, si ce n'est à une convergence d'opinions, tout au moins à une meilleure compréhension et à une acceptation des différences.

J'aimerais remercier la présidente du NAMI, Susan Herter, ainsi que les trois co-organisateurs de la rencontre, Mason Willrich, Jesus Silva-Herzog et Jack Austin, d'avoir invité l'IRP à participer à cette initiative passionnante. Au nom du NAMI, j'aimerais également exprimer notre reconnaissance pour l'aide généreuse offerte par la Fondation CRB, Les Lignes aériennes Canadien International, Westcoast Energy Inc., Swinton and Company et Merit Kitchens, et remercier le gouvernement de Colombie-Britannique pour le soutien apporté à la publication de cet ouvrage.

Rod Dobell
Président
Novembre 1990

Introduction

The concept of North American interdependence that has informed the North American Institute since its inception acquired greater definition when representatives from Canada, Mexico and the United States met with representatives from Japan to discuss "Japan's Relations with North America: The New Pacific Interface." Businesspeople, government officials and scholars assembled in Vancouver, Canada on July 13-15, 1990 to discuss the implications of Japan's immensely important role as trading partner and supplier of capital to an increasingly integrated North America.

Dynamics of the Japanese Economy

At the core of the energetic and frequently imaginative discussions that took place was a powerful image of Japan as a country in the midst of a third economic miracle—the first two being the boom years of the 1960s, driven by domestic demand, and Japan's rapid adjustment to the breakdown of the Bretton Woods system and the oil shocks of the 1970s. The most important consequence of Japan's remarkable adaptability and dynamic economy has been a change in the distribution of global economic power. In relative terms, U.S. power has declined and Japanese power has increased. While the U.S. economy continues to dominate the world economy, Japan has become increasingly assertive and important.

There are strong indications that this trend will persist. Japan now invests more than the United States, creating an enormous long-term advantage for Japanese industry. Indeed, approximately 80 percent of Japanese investment is intended to make Japan more competitive in the future. In stark contrast, the majority of North American investment is directed at simply maintaining existing facilities.

In the next decade, the Japanese economy is also likely to receive a boost due to the pent-up demand of Japanese consumers. Consumption in Japan could soon be similar to that experienced by the U.S. in the 1950s and 1960s, and by Western Europe in the 1960s and 1970s. The domestic stimulus to the Japanese economy will be further enhanced by increased spending in the public sector. Japan expects to spend the equivalent of about $430 trillion yen on public infrastructure in the 1990s.

Equally important, Japan's exports are growing steadily and it is carefully developing a preponderant—and largely unchallenged—position in the high growth markets of East and Southeast Asia, markets that may soon rival that of North America.

Extrapolating from a fairly conservative estimate of Japan's economic performance over the next ten years, Japan's global economic presence could be at least four times greater than it is today. In short, Japan is firmly entrenched as a key player in the world economy and well-positioned to expand its influence over the next decade.

Japan and North America

Japan's economic stature is clearly evident in North America. In addition to running a positive balance of payments with all three North American countries, Japan has invested a large portion of its capital surplus in North America. Since 1985, Japanese firms have placed more than $61 billion of direct investment in North America facilities, primarily in the United States. Japan has also expended massive resources financing the budget deficits of Canada and the United States and making other portfolio investments.

In view of its importance to the economies of North America, Japanese spokespeople made a forceful case for ensuring that the "Japan factor" is considered in any future North American trade negotiations. Japan has misgivings about the Free Trade Agreement negotiated between the United States and Canada in 1988. The Mexico-U.S. trade talks, scheduled to begin in December 1990, are further evidence of a pattern of integration that worries Japan. Japan would prefer to see trade barriers lowered through existing international mechanisms such as the GATT, rather than through bilateral arrangements which might create closed economic blocs. At the same time, Japan appreciates the economic logic that is promoting North American integration.

Several participants argued that because of uncertainty about their own economic future, a growing hostility towards Japan is evident in several countries, including the U.S. Japan's principal concern is that the countries of North America, perhaps in collaboration with the European Community, will act together to counter Japanese economic power. In response, Japan is working to reduce its vulnerability to protectionist measures that could be adopted in North America and elsewhere by solidifying its position in these areas and by expanding its trade with its Asian neighbors.

This strategy produces anxiety in North America, in part because all three North American countries are capital-dependent on Japan. Such dependency is likely to continue, especially if Germany's surplus is absorbed principally within Europe. Moreover, as other regions of the world develop and Japanese consumption rises, competition for increasingly scarce capital will intensify. Thus there are strong incentives for North America to consider Japan's role in any new economic arrangements that it develops. In fact, some Japanese have expressed a strong desire to create a North Pacific free trade zone linking Japan and North America.

At the same time, anti-North American sentiments are evident in Japan. In part this is a response to the widespread feeling, particularly in the U.S., that Japan has kept its domestic market closed and shirked certain responsibilities in the international arena. Changes in attitude and behavior are required on both sides. North American countries must come to accept Japan's economic success and work towards developing mutually beneficial forms of cooperation, even when they entail sharing management and control. For its part, Japan must continue to open its domestic market to the world, assume a greater role in addressing global problems such as Third World development and environmental degradation, and contribute to financing the global structures of security and stability from which it benefits. Finally, both North America and Japan must act aggressively to alleviate public fear, often the result of uncertainty and misinformation, and thus arrest the negative ideological mobilization evident on both sides of the Pacific.

Japan and North America depend on each other. Openness, sensitivity and cooperation can provide the basis for a mutually beneficial relationship. Conflict, however, is certain to hurt both economies and crowd urgent global problems off the agenda of the future.

Integration in North America

Defining a satisfactory basis for a fruitful relationship with Japan is not the only issue advocates of North American integration must address. Equally important is identifying terms that will be fair and attractive to all three North American countries.

Several North American representatives voiced concerns about achieving regional integration through bilateral free trade agreements with the U.S. Canadians have historically worried that such an arrangement will allow the U.S. to dominate the Canadian economy. They are also concerned that the U.S. decision to pursue a bilateral trade agreement with Mexico may result in an agreement that is disadvantageous to Canada.

Mexico's situation is particularly complex. Several participants noted that the potential for domestic opposition in Mexico to a trade agreement with the U.S. is great because the Mexican government appears to be preoccupied with the short-term goal of correcting Mexico's current account deficit without much concern for possible long-term effects. But the long-term effects of integrating two very different economies must be carefully considered. It will not be to Mexico's advantage to serve the U.S. economy as a reservoir of cheap labor. While labor will be an important ingredient of Mexico's competitiveness in the short-term, the potential for development must be built into any agreement—which means that a host of social issues must also be addressed. The Mexican government has further complicated negotiations by creating the impression that a free trade agreement will not require significant concessions from Mexico. However, as numerous participants stressed, it unlikely that Mexico will be able to control the agenda or the outcomes of negotiations.

As difficult as it may be to negotiate an agreement that will be acceptable to both Mexico and the U.S., the incentives to succeed are enormous. A fair agreement is likely to benefit both countries and provide a model for integrating advanced and developing economies. If Canada is then brought in to create a continental free trade region, North America will be an economic powerhouse—rich in resources and unlimited in potential. For this to occur, however, integration must be sensitive to the disparities that exist between the three North American economies, and to the legitimate concerns of Canada and Mexico. In particular, adjustment programs for Canadian and U.S. workers displaced by lower cost labor in Mexico (for example, those in the textile industry), need to be developed and implemented. Similarly, any arrangements must be conducive to realizing Mexico's economic potential. Moreover, it is important that integration be sensitive to cultural differences, especially in areas Canada and Mexico feel to be particularly crucial such as communications.

An integrated North America, however, will be a capital-poor powerhouse. Thus it is also crucial that North America take full account of the importance of Japan which, with Germany, is likely to be a key source of investment capital for some time.

Finally, many participants underscored another vital dimension of North American integration—its success may well depend on the ability of the U.S. to deal with the increasingly urgent problem of improving its savings rate while maintaining an adequate level of consumption. Here again Japan may play a critical role, but it is unclear how the problem will ultimately be resolved. What is certain is that if this problem is not addressed, the future of North America may be bleak regardless of any trade agreements that are reached.

Regional Integration is Not Enough

The integration of the economies of North America could produce tremendous benefits to the region, as long as fair terms are elaborated and the region establishes a positive relationship with Japan. But there is another aspect of integration that also needs to be addressed and managed—the role North America will play in international political and economic systems.

Several participants suggested that the world is being rapidly restructured into three powerful economic regions—Western Europe, North America and Asia-Pacific. But regional initiatives should not be regarded as an ultimate goal. Sustained economic growth will require global openness. Equally important, the many complex problems that now plague the world are unlikely to be resolved in the absence of reliable and effective multilateral structures of governance. Indeed the restructuring of the world solely along regional lines could lead to a further marginalization of the most economically underdeveloped nations. Which bloc, for example, would want Bangladesh or Haiti? Or most of Africa?

What sort of global structures should be sought? While this was not a central concern of the meeting, the importance of thinking along this line was frequently stressed, and a number of interesting ideas emerged. Several participants suggested that such structures should be motivated by a concept of economic rather than military security. They should be sensitive to the plight of the Third World and the global environment. They should appreciate and be competent to manage the rapidly changing technologies that are redefining traditional international relations. In a region as heterogeneous as the Pacific, particular efforts must be made to develop arrangements that promote cooperation but are at the same time loose and flexible. To accomplish these objectives, policy-makers might learn from the complex global networks currently being developed by business enterprises which are, in themselves, a key stimulus to global integration; or from the pattern of cooperation currently taking place within the Pacific as exemplified by the Pacific Economic Cooperation Conference (PECC) and the Asia-Pacific Economic Cooperation (APEC). They might also undertake innovative adaptations of existing multilateral mechanisms and practices—for example, investment, consumption and pollution might be regulated through processes similar to those that now regulate military arsenals.

In any case the globalization of economic, political and normative practices is an undeniable feature of the post-Cold War world. States have a clear interest in managing this process to ensure that it benefits humankind. To do this will require leadership. While the U.S. may not be able to play the unilateral role it did immediately after the Second World War, in many ways it continues to lead in the international arena. It is the world's largest economy and most powerful military entity. In the foreseeable future the world will be profoundly influenced by decisions made by the U.S. In view of this, several participants expressed a deep concern that the U.S. does not appear to have a clear vision of its role in a world that is changing dramatically. Without such a vision, international political and economic relations may become conflictual and counterproductive. It is therefore crucial that the U.S. develop such a vision. North American integration and the new Pacific interface provide a wonderful opportunity for doing precisely this.

NAMI's Role

What role should the North American Institute play in this tumultuous period of economic and political transition?

Essentially, NAMI was encouraged to work in two directions—first, addressing key issues related to integration within North America and, second, helping to clarify the role an integrated North America would play in the international system.

With regard to the first direction, one participant argued that of immediate concern was identifying the terms of a free trade agreement that would be fair to Mexico and suggested that NAMI might contribute to reaching this goal. In particular, given that domestic pressures in the United States on trade issues are likely to escalate, NAMI might act to identify and present the long- and medium-term benefits to the U.S. of a fair agreement.

This view was amplified by another participant who argued that there are distinct hazards for the United States if negotiations with Mexico fail and relations take a turn for the worse. There are important issues with respect to wages and the work force that must be studied and addressed. Through NAMI, Canadians may play a particularly important role in this regard as they have been through the process of negotiating a trade agreement with the U.S. In a similar vein, it was urged that NAMI address such specific issues as how to ease the burden on those hurt by free trade agreements.

Several speakers also noted the concern in Mexico that Canada might seek to undermine Mexico-U.S. free trade negotiations because such an agreement could, under certain conditions, work against Canadian interests. NAMI's role in encouraging frank dialogue between Canada, the U.S. and Mexico could make a significant contribution to alleviating this concern.

At a more general level it was suggested that NAMI work to further elaborate the concept of economic security with reference to North America, and that it address the complex problem of maintaining cultural diversity and encouraging cultural interaction in an increasingly interdependent region.

Insofar as the second direction for NAMI is concerned, one speaker argued that NAMI's joint policy statement on energy (Appendix F) was successful because it addressed energy issues in the larger context of environmental problems and worldwide responsibility. There is now an urgent need to develop ways of ameliorating the ills of free market capitalism and prepare a new agenda for managing increasingly interdependent liberal-democratic societies. On these issues Canadian and Mexican expertise and experience are important and need to be shared. NAMI can serve as a forum for discussing these issues.

More generally, NAMI should continue to explore the implications of an integrated North America for a variety of global issues. Specifically, how will North America interact with the European Community and the developing regions of the world, and how will it ensure that in taking advantage of economic opportunities and creating the conditions for economic growth, problems of environmental degradation and poverty are not marginalized, exacerbated or ignored?

As a result of the Vancouver meeting, the co-convenors agreed to convene a series of three meetings designed to address "Structures of Cooperation" between Canada, the United States and Mexico. The title of the first meeting, to be held December 7-9, 1990 in Santa Fe, is "Prospects for a North American Free Trade Agreement."

Subsequent meetings, hosted by the Canadian and Mexican co-convenors, will examine North American links with South America and the impact of a North American free trade agreement on countries to the south, and the benefits and costs that may accrue to the various geographic regions and economic sectors of the three countries if economic integration is formalized in a free trade agreement.

Section I

Japan's World Role in the 1990s

Kenneth S. Courtis

Introduction

One is constantly struck by expressions of surprise about the role that Japan is beginning to play on the international stage. Yet for much of this century, many of the issues at the top of the international agenda—questions of war, peace, and economic prosperity—have found Japan, in one way or another, very closely involved. Still, such has never been the case in the past as it is today. In considering trends in the world economy and in Japan itself, it is clear that Japan will play a role in North America's future that is even more important than is widely understood.

Not only are we in the midst of a closing period of history, the end of the Cold War era, but at the same time, the elements of a new period of international relations are being set into place. Despite the confusion that at times characterizes the country's expression of its role, Japan is certainly very much at the center of the transition to a new structure of international relations. Indeed, the G-7 Houston Summit will one day be seen as the first new era summit, and it was a summit in which Japan played a different role than in the past. For the first time, Japan did not "rally to consensus"; rather it stuck to its own positions and attempted to bring other summit participants closer to its views.

Critical to the transition now occurring in the international environment is a fundamental shift in the balance of power between the United States, the Soviet Union and its crumbling empire, the European Community with a unified Germany at its core, and Asia-Pacific, centered on Japan. The transition is being driven by forces particular to each of these four poles of the world political economy, and by the complex interaction of relationships of cooperation and conflict between these poles.

In this paper I examine the forces driving change in Japan, and highlight the dynamics of that change which will be critical in shaping Japan's international role and structuring its evolving relationship with North America. But before turning to these questions, it is useful to consider briefly the more general international background against which changes in Japan can be analyzed.

A New International Political Economy

Until the middle of the 1980s, the international economic pre-eminence of the United States was taken for granted. Indeed, it was this unquestioned pre-eminence that was the key to the stability and success of the post-war international system. As a result, defense and security issues were treated largely separately from issues of trade, finance and macroeconomics. That situation has changed because of forces operating inside the United States which have substantially weakened its economic position, and as a result of the shifting international balance of economic power that has placed corporate North America on the defensive.

America's key domestic economic weakness is a critical savings shortage which has led to long-term under-investment. It is mainly due to under-investment that the U.S. economy faces endemic core inflation, a melting infrastructure and a crisis of education. These in turn, work to weaken its position with regard to the new competition in the Pacific. Unable to generate internally the funds necessary to improve its savings and investment rates, U.S. capital markets have become increasingly subject to decisions taken by non-dollar investors.

Beyond the immediate and obvious questions of foreign exchange and the price of debt, this situation sets up what will be a major issue in the 1990s: the issue of control. As the U.S. is obliged to borrow from abroad, some element of the control of the critical strategic decisions affecting the U.S. economy and its economic and financial position in the world will slip from its grasp. Perhaps this does not matter for economies like those of Canada or Mexico—although I strongly disagree with that proposition—insofar as these countries, because of their size and particular political economies, have come to share control as a matter of existence. But sharing control will certainly be a new and difficult experience for the U.S. It raises, in particular, the question of managing the deepening contradiction between the ability of the United States to project global political and military power and its inability to finance it.

This question is not a hypothetical proposition for the future. The United States is there now. The dynamics of this situation are already forcing decision-makers in the United States to begin reordering the country's strategic priorities. We are in the beginning phase of this reordering and the debate about it. It is a debate that will lead the U.S. during the 1990s to place the question of economic security at the top of its strategic national priorities. Economic security for the U.S. will mean, in addition to addressing domestic economic issues, dealing with the new Europe and the new Pacific. More critically, it will mean dealing with Japan, for it is Japan that is in so many ways the central driving force for the transition in the international economy. Let me then turn to Japan.

The Heisei Expansion: Japan's Third Economic Miracle

The Japanese economy continues to roll ahead at a frantic pace. The current expansion has already become the second greatest expansion in half a century, and is well on course to surpass the enormously powerful growth cycle of the 1960s. In 1990, Japan could well have growth of almost six percent. On the basis of its first half growth of 3.6 percent, it only needs 1.1 percent for the remaining two quarters to reach six percent. From an international perspective, the difference between the current cycle of expansion and that of the 1960s is that three decades ago, relative to the three countries of North America, the Japanese economy was about the size of Korea today. But with Japan's economy now three-fifths the size of the combined North American economy, the long-term international competitive and financial implications of the current growth cycle are enormous.

To put the Heisei expansion into a comparative perspective, so as to provide some measure of its magnitude, growth in the Japanese economy in the last 30 months has created a new Canada. In other words, Japan's economy is today one Canada bigger than it was only two and a half years ago. In 1990, Japanese economic growth will create more new wealth than will Mexico, the United States and Canada combined. When we look back at the late 1980s and the early 1990s and think about Japan, we will see the current economic boom as being the country's third economic miracle.

The *first miracle* was the enormous period of growth of the 1960s. Driven by domestic demand for consumer durables—cars, housing and household appliances—and the expansion of the capital intensive materials industries, the economy expanded almost threefold in the 15 years leading up to 1975. Take the example of the automobile industry. Japan produced 500,000 cars in 1960 and 5,000,000 in 1970, of which only 18 percent were for export. With a growth rate of 26 percent a year over a decade, Japanese auto producers raced down the cost curve and so set in place the base for the export surge of the following decade. The same process happened in other sectors such as steel, synthetic fibers, televisions, motorcycles and audio equipment.

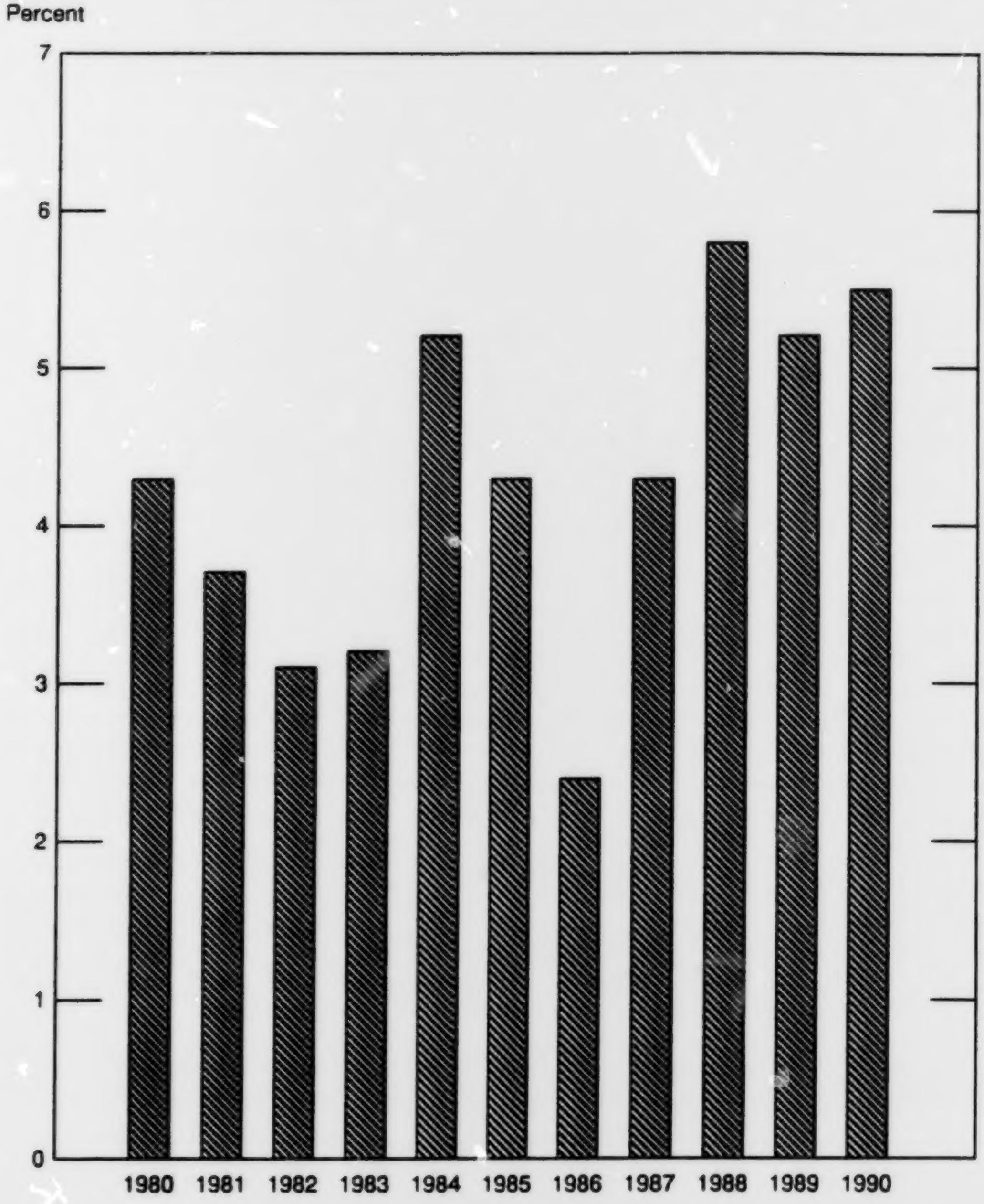
The *second miracle* was Japan's lightning quick adaptation to the breakdown of the Bretton Woods system, including the two Nixon shocks, the double energy crisis, and the inflationary blowout of the 1970s. A measure of how quickly Japan adapted to the new conditions is that today Japan produces two and one-quarter times as much as it did fifteen years ago with the same amount of energy. Although the country continues to import all of its oil, its ability to absorb a new energy shock is greater today than in the past.

The *third miracle* is the current growth cycle, the *Heisei expansion*. At the core of the expansion is massive capital investment, which is driven by strategic and structural forces.

Massive Strategic Investment

In 1989, for the second year in a row, Japan invested more in absolute terms than the United States. On a relative basis, it out-invested the United States by more than two to one. In real terms, Japan invested 23.2 percent of its GNP in plant and new capital equipment, while the

Figure I. Japan: Real Economic Growth 1980 - 1990



Note: Estimate for 1990

United States invested 11.7 percent. In 1990 the relative divergence has widened further with Japan investing at almost two and one-half times the U.S. level.

Table I
Capital Investment to GNP for Selected Countries

	Japan	U.S.	F.R.G.	Canada	U.K.	S. Korea
1980	15.7%	11.9%	12.3%	14.4%	8.1%	25.1%
1981	15.9	12.2	11.8	15.7	7.7	23.6
1982	15.8	11.6	11.4	14.4	8.2	24.8
1983	15.8	11.0	11.8	13.1	7.8	25.7
1984	16.7	12.5	11.5	12.0	8.5	26.8
1985	18.0	12.5	11.8	13.0	9.2	26.7
1986	18.5	11.8	12.1	14.0	8.9	27.2
1987	19.2	11.8	12.4	15.9	9.0	28.1
1988	21.1	12.3	12.8	16.0	10.0	28.0
1989	23.2	11.7	12.8	15.9	10.2	28.6

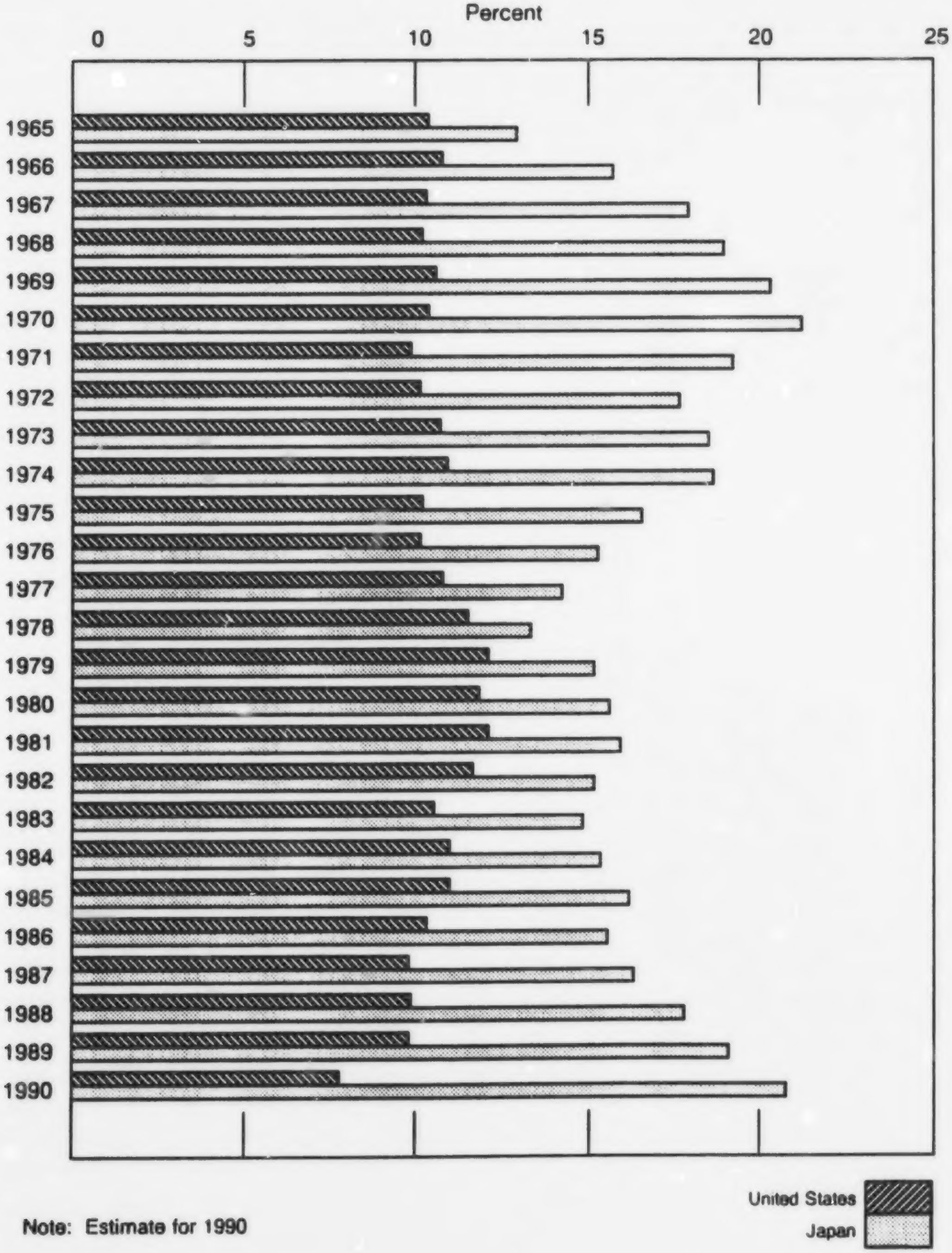
Note: Figures for 1989 are the annualized average based on the first half of the year. All calculations are on a real price basis.

This enormous trans-Pacific investment gap would not matter if it only happened for a short time. Nor would it matter much if Japan, relative to the North American economy, were the size of Mexico, or even Canada. But it matters, and matters a great deal, when such trends occur over a prolonged period and involve the world's two most important economies. With current capital investment and research trends, the momentum continues to move in Japan's favor. Indeed, not once in a quarter of a century has the United States invested, as a portion of GNP, as much as Japan.

As the investment gap widens it creates an enormous international competitive disadvantage for the United States. As with interest rates, there is a compound effect. Each additional yen that Japan invests today is invested on an increasingly competitive base. America faces the reverse dynamic. The effects of under-investment of this scale over such a long period are potentially debilitating.

Japan is not alone in investing in this manner. Indeed, Korea and most of East Asia are out-investing Japan, and the new Europe has also entered a phase of strongly expanding capital investment.

Figure II. United States and Japan: Investment to GNP, 1965 - 1990



Note: Estimate for 1990

Where is Japan's investment going? One widely held opinion is that it is going into capacity expansion such that Japan is about to set off a world-wide crisis of over-production. Analysis reveals a somewhat different picture.

Approximately 30 percent of capital investment is going directly into rationalization and productivity, into making more for less. Consider again as an example the automobile industry. The leading Japanese manufacturers are trying to collapse the development design cycle from four to two years, and do it with half the staff. "Half the time with half the staff for a quarter of the cost"—that is the planning target for the late 1990s. I call this process "Just-in-Time-Development-and-Design" and its competitive market effects over the 1990s will be as powerful as those of "Just-in-Time-Delivery" over the past decade.

Another 30 percent of capital investment is going into innovation. Innovation has always accounted for a high proportion of Japanese capital investment, but there is today a major difference with the past. For example, during Japan's export boom period from 1975 to 1985, about three-quarters of innovation-related investment was targeted at the development of new products and services designed to penetrate the North American and European markets. Since 1986, however, there has been a complete reversal, with about 80 percent of innovation investment now being targeted at the domestic market. That means that new products and services will be increasingly introduced in Japan first.

Contrary to the popular image of Japan as a nation of compulsive copiers, the country is actually positioning itself to play a role for the world economy similar to that which America played in the 1950s and 1960s. During that period new products were first developed and introduced into the U.S. market and, as the international product life cycle unfolded, such products were released in sequence around the world. In the 1990s, Japan will move to play increasingly the role of new product laboratory for the world economy.

Productivity and innovation account for about 60 percent of capital investment; the remainder is going into new capacity. But even for the investment in new capacity, companies report that about one-half is being directed to establishing facilities for products and services that they were not even producing at the beginning of the 1980s.

It follows that approximately four-fifths of the current massive investment is targeted at setting in place the economic base for long-term growth through the 1990s. This investment in the future has tremendous momentum. The divergence in investment behavior between Japan and North America sets in place a dynamic that has very important implications for trans-Pacific relations, a point to which I will return later.

A New Cycle of Consumer Spending

The second force driving the economy ahead with such momentum is the consumer. Historically, Japan's trading partners have had to deal with the problem of Japanese under-consumption. For instance, in 1989, consumer spending accounted for only 53.7 percent of GNP in Japan, compared to about 66 percent in the United States, and 64 percent across Western Europe. This difference suggests a rough measure of the tremendous ocean of pent-up demand that exists in the Japanese economy which, if not released, will lead to enormous political frustrations. Analysis indicates that we are entering the very beginning phase of a new period of consumer spending. If this continues, it will result in a long cycle, generational in length, of consumer spending, similar in scope and magnitude to what occurred in North America in the 1950s and 1960s, and in Western Europe during the 1960s and the 1970s.

Increasingly it is argued that the sun is about to set on Japan because the country's aging population will cause the savings rate to collapse and the cost of capital to soar. As a result, Japan will no longer be able to maintain the type of virtuous economic development that has propelled growth during the past thirty years. But the presumption of a collapsing savings rate is at best questionable.

Today, 11 percent of the Japanese population is over 65 years of age. The country that demographically most resembles what Japan will look like twenty years from now is West Germany, which has 16 percent of its population over 65 years of age. By comparison, 12.4 percent of the U.S. population is over 65 and the world average is six percent.

There is no research to demonstrate that Germans save until their mid-40s and then, throughout the rest of their lives, write down their savings so as to finish life in flat equilibrium. The contrary appears to be the case, as the savings rate of Germans over 65 tends to remain very close to what it was when they were in their mid-40s. In a Confucian culture, like that of Japan, where success is measured not in providing only for your children, but also for your grandchildren, it is very probable that the savings rate of older people will also remain strong.

The forces most likely to affect the Japanese savings rate result from what is going on at the other end of the demographic curve. Because of the decline in the birth rate and the large number of single child families, a significant portion of the current generation of young people will inherit their homes. There is a prevalent image of Japan as a country with one hundred year mortgages and conditions not conducive to owning one's home. But in fact, 63 percent of Japanese families do own their own home. This compares to 42 percent in Germany, 59 percent in France, 65 percent in the United States and 69 percent in Australia.

Of home-owning families in Japan, 24 percent have only one child. These children will inherit their parents' homes. By calculating the probability of these children marrying into one, two or three child families, and working through to the savings rate, it appears that a significant portion of the next generation will have very different savings and consumption functions from those of their parents. For the first time in Japan's modern history, wealth will be transferred from one generation to the next on a very significant scale. The effect of these changes will be to reduce the domestic household savings rate from 19.2 percent, which it is now, to 13-14 percent by the late 1990s.

As savings rates decline modestly, consumption spending will expand and so support continued growth over the decade, even as investment slows. These changes, together with a reduction of the work year from the current 2,152 hours to closer to the North American norm of 1,898 hours by the late 1990s, suggest that consumer spending will climb to approximately 59 percent of GNP by the end of the decade. This will significantly narrow the gap between the pattern of household consumption in Japan and in other developed economies, and in doing so will provide a sustained momentum for growth.

The External Sector

A third motor that is poised to click into gear should the value of the yen change is the export sector. The external sector fell from 4.3 percent of GNP in 1985 to 1.9 percent in 1989. The decline resulted largely from a surge in Japanese overseas travel expenditures, now running at approximately $26 billion a year, and increased imports. But with Japanese firms investing so aggressively to lower costs and to develop new products, they are now positioned to capitalize on any advantage that the currency market allows them. At the same time Japanese firms have begun to reorient their exports to the high growth markets of the future, the East and Southeast Asian markets. Already Japan's total trade with Asia exceeds that with the United States by about three-quarters of a billion dollars a month. At the same time the positive growth potential in Europe suggests that Japanese exports to the European Community will remain strong through the 1990s.

The Public Sector

Finally, Japan has agreed in negotiations with the United States to increase government spending by 430 trillion yen through the end of the decade. There is no question that Japan is in dire need of dramatically upgrading the quality of its social infrastructure. For example, 43 percent of Japanese houses do not have access to public sewage; airports are collapsing because they were not designed for the volume of cargo and passengers that they are now handling; and national highways frequently resemble serpentine parking lots. The country needs to improve its social infrastructure very quickly. If it does not, it will face tremendous social and political frustration. But it is doubtful that this investment alone will substantially decrease the trade account surplus, as it is so widely hoped in North America.

Driven by the twin engines of investment and consumer spending, which are now in top gear, and poised to dramatically increase exports and public spending, the Japanese economy is moving ahead at an extraordinary pace and likely to continue to perform well for some time. At the average growth rate of the last four years, it now takes less than thirteen years for the economy to double in size in real terms.

The Multinationalization of Japan

The dynamic nature of the Japanese economy is further enhanced by the activities of corporate Japan. During the past five years, Japanese firms have invested abroad approximately $835 billion—$661 in portfolio investment and $174 in direct investment. Of the direct investment, 70 percent has been invested in the Pacific region; 50 percent of which has been placed in North America, with 95 percent of the North American investment going to the United States. In 1989, Japan's direct investment in the Pacific region amounted to $47 billion. Of that, $33 billion, or 72 percent, was invested in North America's three economies.

Why is Japan investing abroad to aggressively? From a macro-economic, balance of payments perspective, Japan is simply recycling its current account surplus, a surplus which is largely American in origin. However, when we look at the numbers more closely, we see that Japan has been investing abroad much more than its current account surplus, which partially explains the weakness of the yen during the past two years. Why is Japan investing more abroad than it is taking in from abroad? There are three reasons.

First, the high valuations of Japanese asset prices make other markets look relatively cheap and attractive. For example, real estate in Paris is one-fourth the cost of that in Tokyo. Equity and debt prices, despite the still-to-be-completed decline in the markets, are much higher in Japan than in other major markets. This valuation gap leads to a constant outflow of funds from the capital account for investment in other, cheaper markets.

Second, because North American corporations are under-investing, the United States represents a wonderful market opportunity for competitive Japanese companies which, with new products and lower costs, find it possible to make significant market share gains when competing against their frequently debt-hobbled North American competitors.

The third, and more fundamental reason, is the multinationalization of corporate Japan. Today, Japanese companies produce and sell abroad an amount approximately equivalent to five percent of the Japanese GNP. For German companies, it is 16 percent. For the United States, it is 20 percent. Let us imagine that over the 1990s Japanese firms evolve in a manner similar to that of German and U.S. firms. This would mean that by the end of the decade Japanese companies would be producing and selling abroad the equivalent of approximately 15 percent of Japan's GNP. Let us assume further that the Japanese economy is 50 percent larger ten years from now, and that the yen is revalued by 30 percent. This would mean that by the end of the 1990s, the international presence of Japan would be four to four and one-half times larger than it is today. Much of that expanded presence would be in North America.

Both forces internal to the Japanese economy and changes occurring in the world economy are driving this process of multinationalization. First, Japan has developed a type of economic structure that requires enormous investment in research and development and which can only be justified by a large presence in all the major markets of the world. Second, there is a fear that protectionism could become more intense in Europe and in North America and therefore it is necessary to be on the inside, and to get on the inside quickly. Certainly Europe 1992 has spurred such thinking, as has the Canada-U.S. Free Trade Agreement. As discussions begin to expand that agreement to include Mexico, there will be further concern in Japan. Third, there is a widely shared sense in Japan that over the 1990s the yen will become much stronger and that competition from East Asia and Europe will become much more intense. As a result, it is important to move now to strengthen strategic market positions in Europe and North America and to build the local production base necessary to support such positions.

We face then in Japan a huge economy that is expanding at an almost unprecedented pace. At the same time, it is expanding internationally at an even greater pace than that at which the U.S. economy expanded during the 1950s and 1960s. It follows that: Japan will be the principal trans-Pacific trade partner for North America; and that changes in Japan's domestic economy, and in Japan's international position, will fundamentally affect the economic, industrial, financial and socio-political evolution of North America.

Clouds on the Horizon

It will not be clear sailing for Japan, however. Indeed there are dark clouds forming on the horizon. The country desperately needs to make fundamental reforms in its domestic economy. Should such reforms be postponed beyond mid-decade, Japan will face increasing social frustration that will destabilize the political system.

The land system needs to be completely restructured, for what exists now is a politically administered imbalance of demand over supply that results—some would argue that this is the intention of such policies—in sky-high land prices. There is a constant litany about Japan having no land. But the numbers tell a different story. There is plenty of land available, but it is kept off the market through zoning and tax regulations. For example, if the agricultural land within Tokyo—and there are still rice paddies thirty minutes from downtown—were to be rezoned, and 30 percent of that land used for services such as roads, hospitals and schools and buildings limited to three stories, 60 times more new residential units could be built than were put on the market in Tokyo last year.

Releasing this supply of land into the market would provide Japan with the basis for a long-term, non-inflationary, consumer-driven cycle of domestic economic expansion through residential construction and the upgrading of the country's social infrastructure. The construction of new roads, trains and airports, better quality public buildings, recreational facilities and modern medical facilities would be good for Japan and good for the rest of the world.

Fundamental reform of a tax system that works to smother healthy, consumer-led domestic demand is also urgent. Again the numbers tell the story. Approximately 76 percent of Japanese government revenues come from direct taxes on corporations and individuals. The salaried worker bears the brunt of individual income taxes because the tax code has been tailored over the years to benefit three key interest groups that have enormous political clout: farmers, small shopkeepers and doctors. The tax payments of these groups are in no way commensurate with their income—most simply pay no taxes. This situation must be rectified because the interest of these groups in maintaining the status quo has paralyzed the political system and is blocking healthy economic change. Should these obstructions not be removed, they will not only destabilize the political system, but will lead to further frustration with Japan around the world. Were that to happen, Japan's great multinationals would find themselves facing substantially higher levels of protectionism than they do today.

Ironically, Japan's Ministry of Finance has begun to argue that it may be necessary to raise taxes in order to finance the 430 trillion yen in new public spending demanded by the United States' administration in the recently concluded Structural Impediments Initiative talks. With an economy growing at over five percent, a trade surplus, and government finances in net surplus, Japan is already under-consuming—further taxes would simply make the situation worse.

Japan also needs to reverse course on monetary policy. In particular, the Bank of Japan should be moving to protect the domestic and international value of the yen. With the money supply growing at 12 to 13 percent, the economy growing at about five percent, and an acute labor shortage, Japan is vulnerable to even moderate supply shocks springing from the international environment. That puts the yen at risk and should the yen weaken there will be a brutal surge of Japanese exports, and inevitably a new and destabilizing round of trade conflict.

The principal international risk that Japan faces from a political and economic perspective is that the United States, unable to deal with its domestic problems, and after having come to a comprehensive understanding with the Soviet Union, will turn to the question of economic security and conclude that its security is threatened by Japan. Such a development could be paralleled by a similar conclusion in the European Community. Europe 1992 is in part driven by a fear of Japan, and in part by a determination to set in place the basis from which to meet the "new competition." But the "new competition" is also Japan. The situation that Japan has to prevent is one in which the European Community and North America enter an agreement that excludes Japan.

In view of this, Japan's highest priority should be to promote very close relations with North America.

A Pacific Partnership

From a broader perspective, Japan is in a pivotal position in the Pacific. On one side are Canada, Mexico and the United States, and on the other are the two Koreas and the three Chinas—Hong Kong, Taiwan and the P.R.C. The key relationship across the Pacific, the relationship that links all of the others together is between Japan and the U.S. From Japan flow goods, technology, capital and information. On one side, Japan is part of a triangle that includes the U.S.-Canada and Mexico; on the other, it is part of a longstanding and increasingly important economic and political relationship with Korea and China. It is this double triangle that is the core of the emerging Pacific economy and enormously important to the world economy. For example, six countries in the double triangle produce 62 percent of the world's automobiles, 82 percent of the world's telecommunications equipment, and 88 percent of the world's computer equipment. At the rate that Japan, Korea, Hong Kong and Taiwan are investing, these figures will all increase.

The fundamental question now facing Japan is how to manage the new situation it finds itself in. One of the forces contributing to the success of Japan over the past thirty years has been the extraordinary stability of its domestic political system. However, around that stability has developed an enormously powerful vested interest in the status quo which has become an impediment to change. Conflict is now building between these vested interests and Japan's multinational corporations which require free access to world markets to grow and develop. If countries in Europe and North America continue to believe that full access to Japan's markets is being denied, then inevitably foreign markets will become more closed to Japan. This would exacerbate the conflict between those with an interest in the status quo and the great Japanese multinationals seeking change. This growing domestic conflict, which results from Japan's evolving global economic position and changing social demographics, has the potential to destabilize the country's entire political system. To deal with these pressures will require farsighted and competent political leadership. The question remains as to whether contemporary Japan will be able to generate such leadership.

As we enter the 1990s, we are in one sense on the verge of a golden age. Enormously positive developments are taking place in the Pacific. The tragic situation in Cambodia seems to be on the road to resolution. The Koreans have begun the first steps toward overcoming the bitter partition of their country. Japan and the Soviet Union are in the process of addressing the outstanding issues from the Second World War. China has begun to inch back toward policies of reform. Taiwan is moving to establish a broader political base for an economy that by the mid-1990s will place it among the world's largest trading nations.

Japan too, is beginning to reconsider its past, and the weight that the past still has on perceptions of Japan throughout East Asia. Being so powerful today, and having been the aggressor in the past, it is Japan that must find within itself the generosity and the courage to heal the wounds it inflicted on its neighbors in the past. The recent visit to Japan of the South Korean President is a step in the right direction.

On the other side of the Pacific, the U.S. administration appears to be beginning to address its domestic problems. Although the pro-consumption lobby is enormously powerful, the government has begun to act on difficult decisions that must be made. But North America is on the edge of a recession which, given the debt load the economy is carrying, could be the roughest recession since the 1930s. This makes it even more urgent that the U.S. address its internal economic problems.

If the changes in Eastern Europe lead to integration with the European Community, the world economy will be structured around three poles competing to produce new wealth and increased well being. But this golden opportunity could easily disappear. Ensuring it does not is the challenge we now face. Because of the dynamic economy and central position in the Pacific, Japan has a special role to play in the trans-Pacific partnership. Can it play that role? Canada, Mexico and the United States have an enormous stake in how this question is answered.

Panel Discussion

Daniel Okimoto

I would like to discuss some of the implications of what Kenneth Courtis has set forth.

The state of the international system, in which an incredibly dynamic economic juggernaut, Japan, is moving ahead of many other parts of the world, is bound to exacerbate and deepen international frictions. I would say this is the first implication of Kenneth Courtis' presentation. Of course, it means, as he pointed out, that there are greater opportunities for cooperation as well, but I think that for Japan and for the United States the reality is that there will be growing tension and conflict in their relationship of expanding economic interdependence.

In a recent *Wall Street Journal* editorial, Robert Reich discussed the very interesting results of a survey that he had taken of business executives who were Harvard alumni. Participants were given two scenarios: in the first, over the next ten years the U.S. grows at a robust 25 percent and Japan at 75 percent; while in the second, over the next ten years the U.S. and Japan both grow at ten percent. He found that the overwhelming majority of those questioned preferred the second scenario—in other words, smaller absolute growth in the United States, if it resulted in smaller relative and parallel growth in Japan as well.

I think this indicates that in the U.S. there is a deep-seated fear of losing economic power and national sovereignty, a fear of growing dependence upon Japan in trade, investment and capital inflows. My own fear is that there will be more international friction between the United States and Japan, exacerbated by institutional and cultural differences.

Kenneth Courtis' presentation also suggests that Japan is in the process of diversifying its economic relationships, trying to move away from its overwhelming dependence on the American market, and attempting to develop and expand trade ties with Asia, especially the emerging countries of Southeast Asia. Of course, the U.S. will continue to be the central axis of Japan's international orientation, but I agree that Japan is looking to find ways of reducing its trade dependence on the United States. In this sense Asia is in a position to be the focus of efforts at diversification.

A third implication is that we are entering what political scientists refer to as a period of power transition, which is typically a period of instability. Whenever there have been major changes in the relative power positions of leading nation-states, the transition has involved tensions, conflicts and often the eruption of war. The power shift that is expected over the next ten years and beyond may reflect built-in forces for instability in the world and, in particular, tensions between the United States and Japan and between the developed and the developing world. I would suggest this means that Japan cannot avoid playing a much bigger role in the world.

Over the course of the post-war period Japan has followed a philosophy of maintaining a low political and military posture while concentrating on purely commercial growth and development. It has attempted to do this within the framework of the U.S.-Japan alliance and what is called the Yoshida doctrine. But I think this merchant state orientation has been rendered obsolete not only by external changes, but also by Japan's own rapid growth. If this is the case, the question then becomes, what kind of role will Japan play? Will it be constructive, or will it be destabilizing? I hope it will be a stabilizing role.

There are at least five areas in which Japan can play a very constructive role. The first is greater Japanese input and influence, along with the United States and Europe, in the restructuring and revitalization of the world's international economic institutions—GATT in particular, but also the IMF, the World Bank and other international organizations which, given the tremendous changes that have taken place in the world, require rethinking, re-examination and probably restructuring. The whole area of international regimes is one in which Japan, given its enormous economic size, can play a vital role.

I would broadly classify Third World debt, foreign aid and industrial development as a second area, with an emphasis on helping to bridge what I fear is a growing gap between the "have" countries and the "have-not" countries. Given recent developments in Central and Eastern Europe, Africa and Latin America in particular may feel the negative effects of a zero-sum competition for scarce capital and a widening gap in income distribution between the developed and the developing worlds. Because of Japan's enormous capital surplus and huge savings rate, it could play an important role in terms of providing Third World debt relief and foreign aid, as well as facilitating industrial development. In Asia there is a strong momentum for growth, but it is an uneven momentum. Some countries on Asia's perimeter, like Thailand, are moving forward rapidly, whereas other countries on the continent, such as China, Vietnam and North Korea, are not; Japan might be in a position to help the latter category.

A third area in which I think Japan can make a major contribution concerns the global environment. Japan is investing significant resources into technology aimed at helping to solve such environmental problems as the reduction of carbon dioxide emissions. I think the environment is one area where Japan can make a very big and positive contribution, which is especially important because it has been regarded as a country that has been relatively callous about the preservation of the international environment.

A fourth area in which Japan can play a positive role is in science and technology. As Kenneth Courtis pointed out, Japan has been investing enormous resources to generate new technical knowledge, and in the years ahead Japan may accumulate a valuable stockpile of commercial technology that can be transferred to other parts of the world. I think there will be a need for Japan to find institutional mechanisms for technology transfer, but this should not pose problems if the will to transfer technology is there.

And finally, in the region of Asia, Japan can play the role of political and economic mediator. It has recently attempted to assume this role to help resolve the Cambodian conflict, and it may be able to play a big role in helping to bring the economies of Vietnam and North Korea into the regional system. These two countries in particular, I think, will suffer tremendously if they are not integrated into international and regional systems.

These are five areas in which I would suggest that Japan, in cooperation with the United States and Europe, can and must assume a growing and constructive role.

Sergio Gonzales Galvez

I think Kenneth Courtis presented a very concise explanation of the economic position of Japan and its possibilities for the future. I also think Daniel Okimoto made very clear the areas in which Japan could play an important role.

It has been said that we are living in a profoundly paradoxical world. Never before has interdependence been so pronounced in international affairs; but never before have so many countries claimed to be absolutely sovereign in the decisions they have to make. Never before has military power been concentrated in such few hands; but never before has military power been so useless in pursuing objectives and aims in international affairs. Never before has international law covered so much ground in the relations between states—even including the individual as a subject of international law; but never before has international law been so helpless to solve some of the problems we are facing. Never before has the world economy been as uniquely integrated as it is now; but never before has it been more important to redress the current unhealthy dialogue and level of cooperation in economic affairs.

As an expert, in a way, on Asia, since I spent so many years there, let me tell you what comes to my mind when I think about that region. First, the military presence of the United States and the Soviet Union is still intact in this area, despite the détente which I hope can be turned into an "étente." Second, military spending in Japan continues to grow, and I think it is now over 22 billion dollars annually. Third, efforts to utilize the Pacific Basin as a framework for economic cooperation have not been as successful as some of us have hoped. Fourth, I think that we should still be concerned about some of the conflict situations in the area, such as those in Cambodia and in Vietnam.

You might ask, what does this mean for Mexico? Let me point out that until we develop Salina Cruz on the Pacific as a good oil-exporting port, our ships still go through the Malacca Straits on their way to Japan, so if there is a conflict in the peninsula, ships which take Mexican oil to Japan will be interdicted.

Another point is the progress that we see in negotiations between the United States and Japan. I am amazed at the most recent agreement between Japan and the United States, especially considering the friction that I witnessed during the past six years while I was in Japan. This is really a great advance, and I think a big sign to the world that Japan is trying to be conciliatory on some of the proposals on important issues.

However, I feel that Japan is perhaps going too far in some areas. Japan is playing a major role in the world. But it is playing the role it wants, and on the schedule it wants. Japan might not be playing the role other countries want it to play, and this is very important to understand. For instance, I recall vividly that one of the books I read when I arrived in Japan was a book about Japanese culture which began with the phrase, "Japan imports whatever fits

its personality." In other words, they import technology and goods and services according to a pre-determined program.

Kenneth Courtis referred to the status quo, and the possibility that those seeking to preserve the status quo will be an impediment to Japan's increased participation in the contemporary world. I remember in one of the meetings I had with then Prime Minister Nakasone, I complained strongly because he so closely followed the position of the United States with regard to Central America. I asked him, "Why don't you distribute your aid to Central America in a more balanced manner? Why should you follow the position of the United States and give all your aid to Honduras? You are not helping to promote the resolution of conflict in of the area." He replied that for the time being Japan had to act in close cooperation with the United States. Now let us recall that since the beginning of this century, every time Japan has emerged, it has always come out with somebody. At the beginning of the century there was the British-Japan alliance, then the 1921 military alliance (the so-called Washington Agreement), then the Axis Treaty, and then the bilateral treaty with the United States. Years ago I used to say that I had the feeling that Japan was looking to Asia as the way to escape its alliance with the United States, which in some ways was very uncomfortable because the United States had so many interests worldwide, that it was very difficult to follow it every step of the way. Now Japan, in my opinion, is looking back at the old concept of China-Japan as the center of power in Asia. I think you will remember the policy followed by Japan when they occupied Manchuria; the creation of Manchuko was very much in that line. I think Japan is looking to restructure its relationship with the world and particularly with the United States.

Another element that I want to point out with regard to Asia is that there is a widespread opinion that Japan follows the United States on every international issue. I submit to you that this is not the case any more. I think Daniel Okimoto suggested very clearly that things are changing when he referred to the position or the role Japan could play in Asia. For instance, if you compare the position of Japan to the position of the United States vis-à-vis the Middle East, there are a very significant differences of opinion on the policies appropriate to that part of the world. Similarly in Asia, if we compare, for example, how Japan acted in regard to the crisis in the Philippines when Marcos was ousted to how the United States acted, we also see a very clear difference. I suspect we will see increasing Japanese independence in international affairs. This is very important.

Our major concern in Mexico is how to promote the special relationship that exists between Japan, Canada, Mexico and the United States. There are people in this room more qualified to speak about this area than myself, but we feel in Mexico that it is something we have to talk about. Our bilateral relationship with Japan, I think, is good—I will not say very good, but I think it is good. I think it has been enhanced by the oil situation.

The parameters of this relationship are changing slowly, in as much as our economic and trade relationships with Japan are changing—becoming less dependent on oil and at the same time more complex because of our interface with the United States. In a recent trip to Asia made by President Salinas de Gortari, we discovered—not to our surprise, of course, it was logical—a great interest in knowing more about the possibilities of a free trade agreement between Mexico and the United States, and how this might affect the relationship between Mexico and Japan.

And by the way, not only is this the feeling in countries like Japan, but it is also, as you may be aware, evident in Latin America. A month ago I was in Cuba, trying to negotiate its inclusion in the treaty for the non-proliferation of nuclear weapons in Latin America. Because of this mission I had a chance to talk to Fidel Castro, and one of the surprising questions that he asked me was how I thought the free trade agreement between Mexico and United States could benefit Cuba. I did not dare to tell him my opinion in great detail, but I asked some of my colleagues in the foreign office to prepare a memorandum to send to him to show that I thought it was a serious question. So this is a concern all over, it is a concern in our relationship with Japan, it is a concern in our relationship with Latin America. We have to decide exactly how to handle the situation.

I think that the way we should handle a closer relationship between Japan, Canada, the United States and Mexico is through the promotion of stronger cooperation in the Pacific. With due respect to the people who have been very active in this, and I mean, in particular, Ted English, I feel that we have to do something at the political level as well. I have the impression that the countries concerned about Pacific cooperation have to grab the leadership and act. The idea of the Pacific Basin came into being twenty-five years ago. We feel the time is ripe for some kind of daring initiative, such as a summit meeting between some of the leaders of the Pacific Basin countries. Perhaps NAMI should promote this.

Some of us in Mexico—and I include myself in this group—are still very concerned about the effects that a free trade agreement with the United States will have on Mexico. We feel that perhaps if we continue our negotiations on the free trade agreement within the framework of stronger cooperation in the Pacific Basin, focussing on Canada, the United States, Mexico and Japan, the possible negative effects of such an asymmetric relationship with the United States might be diminished. This is why we consider this one of our political targets. We feel very strongly that we could do something along this particular line, and I respectfully suggest that you consider this as an alternative in your discussions.

Shumpei Kumon

I have long been a great admirer of Kenneth Courtis' use of economic analysis, and I agree with most of his points, and with his analysis of the future of Japan's economy. I also agree with the comments that Daniel Okimoto made. I really do not have much to add, so let me just outline what I think to be the main points of the analysis presented this morning.

Historically, people in general, and particularly Americans, have tended to look at the world in terms of confrontation or conflict between at least two major forces. From this perspective, the twentieth century can be regarded as the history of confrontation between liberal democratic forces in Western Europe and the United States, and collectivist or totalitarian forces in the rest of the world. During the first half of this century there was a "hot war" caused by the aggressions of right-wing totalitarian forces—fascism and Nazism—against which free democratic countries had to defend themselves. The latter finally won this confrontation. It was replaced, however, by another type of confrontation with left-wing collectivism or totalitarianism or communism. Having learned from recent history, the democratic countries were soon trying to prevent hot war, which might mean nuclear war, through a cold war and the policy of containment. After forty-five years this cold war appears to have ended. What will come next?

Daniel Okimoto suggested that some people, particularly in the United States, are looking for a new enemy or challenger to be the next object of confrontation. It seems to me that Japan, Korea, Taiwan and other East and Southeast Asian countries, are now being classified as group-oriented or collectivist-oriented social systems—not necessarily totalitarian, but something sufficiently different from developed democratic social systems with liberal values to be threatening. There are even some people within Japan who prefer to define their system as something other than liberal-democratic. I am afraid that, at least in the short run, this kind of tension and sense of confrontation might develop further, and result in something like a trade war or cultural rivalry.

Looking back at history, however, one promising phenomenon is that the intensity of confrontation or tension seems to have been reduced over time. In the first half of this century we experienced shooting wars, while in the second half we experienced a cold war. I hope that during the rest of this century and into the next century, the kind of confrontation we experience will be less than cold war. What I would like to see is co-emulation on both sides.

For example, while Japan has not been trying to completely imitate the West, it has been trying to emulate the Western system in certain ways. Even though the Japanese have been trying to preserve their own value system and work ethic, at the same time they have been trying to introduce at least some institutional or technological cultures which are conducive to rapid industrialization. I do not know if this strategy was intentional or not, but it has worked well. In the future, it will also be useful for Western European and American systems to try to emulate Japanese or East and Southeast Asian systems to a certain extent, particularly in terms of industrial production and the design of research and development programs.

Incidentally, I do not want to characterize the kind of socio-economic cultural system that can be observed in the Western Pacific region at this time as totalitarian, with the exception of the Chinese system. Rather, it should be characterized as something like a network-oriented system, in which a strong emphasis is placed on developing and maintaining close human relations. These relations involve taking care of others and being taken care of by others and sharing information. And on the basis of shared information, the goal is to achieve and act on a certain kind of consensus, which is what the Japanese call harmony. I admit there are many defects in this system, but at least it has been viable in the sense of achieving industrialization and coping with what I call informatization. I seriously hope that even though in the short run there may be a further undesirable development of confrontational elements, eventually we will end up with something like co-emulation between the two systems.

There is another factor in today's world that we have to take into serious consideration. If the confrontation between Western Europe and the U.S. on the one hand, and Japan and other East and Southeast Asian nations on the other hand, is seen as the first confrontation axis, then the second axis of current and future world confrontation is North-South. I am very much afraid that the so-called Third World is rapidly losing its governability, that the political force, particularly in its totalitarian form, that once was quite effective in governing the Third World, has been losing its ability to maintain stability. I am really afraid that this new Third World, in which at least part of the Soviet Union would be included, may turn out to be something like an immense "black hole" which absorbs infinite amounts of economic resources, and produces almost nothing useful in an economic sense, but produces great amounts of social unrest, as well as a large number of immigrants or refugees, and a tremendous amount of environmental destruction. If there is no effective political force to direct the social and economic development of this region for the future, at least during the short run, what can we do? We will have to do our best to contain the high-entropy state of the new Third World by injecting economic resources in some form or other, and also by providing some security in order that the unrest from this region is not expanded to the rest of the world. I think this will prove a formidable task.

It is very important and necessary to maintain the peace and prosperity of the world at large, and in order to do that, what is most necessary is to achieve some form of cooperation between the new East and West camps. I really do not know how to achieve this, but I think we do have to bear in mind what kind of future will be developed if we pay attention only to the confrontational aspects of European and American countries and East and Southeast Asia's newly industrializing areas.

Mason Willrich

Let me make two points. First, the differences in the time horizons of the leaderships in the various countries that we have been talking about are, I think, worth noting. For example, a recent poll of chief executive officers of companies from around the world indicated that the performance of American CEOs is measured with roughly a one year time horizon. Interestingly, most of the American CEOs thought that one year was appropriate for measuring performance. The time horizon that Japanese CEOs accept and are measured by is something rather vague, but it is in the order of five years or more. I think there has to be some kind of convergence of the two cultures, and I would say that the American side should shift in the Japanese direction if we are going to address the problems that we have been talking about here.

Second, I agree with the sources of concern that Kenneth Courtis alludes to, but upon further reflection I think it becomes clear that while Japan is certainly dynamic, and is growing larger on a world scene, we all—and when I say "we" I definitely include not just the United States but also our other North American partners—have an enormous stake in Japan's success, and it would be in many respects a disaster for us if Japan failed. But the same thing is true on the other side—Japan has an enormous stake in the success of the United States itself as well as the North American region as a whole, and indeed in Europe as well. This is significant to keep in mind because while competition is an enormously important ingredient in stimulating all kinds of activities, in the end competition cannot be productive without an infrastructure of cooperation to provide a framework for it. Both sides of the Pacific have an interest in acting to develop this framework, to ensure that competition proceeds in a healthy, mutually beneficial way.

Kenneth S. Courtis

As the tensions between the two superpowers decline, conflicts within capitalism will surface in a much more dynamic way than in the past. We are already starting to see this very clearly. In a sense, many of the conflicts that we are starting to see across the Pacific were there before, but were latent. The changed situation allows them to express themselves. But given the enormous stakes that we now have in the Pacific economy, and given an economic situation in which the two key players have such profoundly divergent performances, we have to be extraordinarily careful that this build-up of conflict—which in many senses is the normal course of international relations—does not spill over into a destabilizing process.

As Shumpei Kumon noted, there is a form of ideological mobilization evident in the United States and in Japan, that I believe is negative in both countries and that must be handled very carefully. The two big themes quite clearly developing in the United States are that Japan is buying Washington and that Japan does not pay its taxes. This is a powerful populist argument: "They don't pay their taxes, therefore they can invest at home in research and development. They protect their profits so they are able to beat us. And, they buy off our decision-makers." In Japan one sees an equally disturbing ideological trend.

A second point is that we talk about the need to integrate the Pacific economy, but in fact it is already integrating at an extraordinary speed. It is not being integrated in an administrative way—it is instead corporate decisions that are integrating the Pacific economy. For instance, Mitsubishi owns part of Chrysler which owns part of Hyundai. It is relationships of supply, distribution, investment and technology that are currently bringing the Pacific together. IBM cannot produce the PC without Japan, and 60 percent of the cars that Chrysler sells in North America use Japanese engines. This enormously powerfully type of integration is already occurring.

What I think we have to set in place for the 1990s is an administrative structure. Given the inevitable conflicts that we will see, and given the enormous stakes that are involved, such a structure must allow us to move beyond the current situation in which bilateral—in fact, unilateral—decisions by one or two of the key actors have such enormous power and potential for destabilization.

Third, and I want to stress this, it is enormously important for the U.S. itself and for those of us who can somehow assist—and that means principally Japan—to address this situation. We are moving towards an international context that is much more normal than the one we have lived in during the last 45 years; it is a context that will be much more complicated, and which will need a center of gravity. It seems to me that politically this center of gravity must still be the United States; but for the U.S. to play that role it has to have a buoyant and healthy economy.

If the U.S. can turn its situation around, that will create a very important third pole of growth and, as Shumpei Kumon noted, the possibility of coagulation and of competitive emulation. If the U.S. situation is turned around, we will be able to subvert the forces of protectionism and thus the capital market instability that inevitably ensues. I think this is very important.

Over the last five years Japan has been following a monetary policy similar in many respects to that which the U.S. followed in the 1920s. The United States had a policy in that decade that included protectionist practices, keeping interest rates low, and allowing monetary expansion that was probably, for a period, much higher than it should have been. This is what Japan is doing today. The money supply is growing at 13 percent, there is no unemployment (there are about 1.96 million vacant jobs), and spending on social infrastructure by the public sector will increase by 430 trillion yen. Japan is practicing a policy of supporting the U.S. dollar and the U.S. debt markets. That works in the short term, but it is only a short-term solution. In the long term it puts Japan into a very difficult situation, because sooner or later it will either have to change course and significantly tighten monetary policy, or the yen will become very weak again. If Japan keeps interest rates much lower than Germany, it is a simple matter to borrow the yen and invest it at the higher-yielding rates in Europe. Should the yen weaken there will be a problem of inflation in Japan and the whole thing could very quickly unravel. This year there has already been the first shock in the stock market; we could easily and very quickly find ourselves in that situation again.

Finally, I would like to address very briefly the question of East Asia. In this region I include North Korea, Japan, Taiwan, Hong Kong together with the two southern provinces of China, Malaysia, Vietnam, Thailand, Singapore and Indonesia. By the end of the 1990s this region will have almost 600 million people, and throughout all of the region the attitude of people is, "Get out of my way, I want to make a deal." No one is asking the question, "Will these people work more than five hours a day," as they are in some Eastern European countries. And what is happening in East Asia is that because of Europe's preoccupation with events at home, the investment of European countries in this region is not keeping up with economic growth, so relatively they are losing market share. And, on aggregate, corporate America is on the retreat. So it is Japan that by design, but also by default, is moving into a position of extraordinary power in this region.

But look at what this is setting North America up for, and again I will use the example of the car industry. The Japanese market is open in the car industry, but I expect that by the mid- to late 1990s, 90 percent of that market will be Japanese-controlled. By the mid-1990s, 35 to 40 percent of the North American market will be controlled by Japanese auto-makers, and unless the French manage to convince the Germans to impose very tight controls in the European market, Japanese companies are set to have 20 percent of the European market as well by the mid-1990s. So North America will be on the defensive, unable to generate the type of cash flow necessary to invest elsewhere and Europe, with six car companies—none of which even now is a global power—is going to be forced into restructuring. The market that will be exploding by the end of the 1990s for the car industry is going to be East Asia. There we well see growth rates like those we are seeing today in Korea: 15, 20, or 25 percent per year. Japanese companies are currently investing to cut their cost structures, to come out with new products and, because they are the only ones investing in East Asia in the manner that is necessary, they are positioning themselves to get the volume increases that will continue to allow them to lower their cost curves by the end of the 1990s.

This situation is clear, and it brings me back to the point that was made earlier about the "invincibility" of Japan. Of course Japan is not invincible; there are clear and obvious limits to Japan's potential. But when we look at Japan in this manner it is very easy to make it into a monument of fear, and this is in accord with what Shumpei Kumon noted regarding the ideological mobilization that we see—the search for a new competitor or a new enemy. I believe that rather than a monument of fear, we should try to cast the debate as the monumental challenge that Japan represents, and in taking up that challenge I think we will all make ourselves stronger and better off.

Plenary Session Summary

At the first plenary session, several aspects of the complex relationship evolving between North America and Japan were emphasized and discussed.

Several participants expressed a deep concern about the potential for escalating conflict between the United States and Japan. While these two countries enjoy good and increasingly interdependent economic relations, there is evidence of persistent and perhaps mounting tension at the political level. On the U.S. side, this tension is fueled by a set of related perceptions: the U.S. is in a state of decline while Japan is experiencing a rapid period of ascent; Japan is different from the U.S., not only culturally, but also in terms of its political and economic arrangements; these differences, reinforced by powerful nationalist sentiments in Japan, suggest that Japan, historically somewhat of an outsider, will not be easily assimilated into the current or future international order; in consequence, Japan poses a serious threat to the U.S., and to Western values and institutions generally. The possibility that such perceptions will have an impact on policy-making in the U.S., where there are indications that the public believes that the U.S. government has been soft on Japan because the latter has used economic inducements to gain influence in Washington, was regarded as quite high and a matter requiring immediate attention.

The potential for conflict also has an important Japanese dimension. To some extent, Japan is in a no-win situation with the U.S. insofar as its actions will inevitably produce some conflict. For example, Japanese investment in the U.S. is both avidly encouraged by Americans and stridently criticized as a threat to U.S. sovereignty. This problem reinforces Japan's concerns about the long-term significance of North American integration. While Japan's current level of involvement in the North American economy may be such that it cannot easily be excluded from this region, Japan is worried that it may find itself constrained in certain areas, and having to fight powerful continentalist impulses. Indeed, Japan's recent investment strategies may be read as a response to the fear of both U.S. and North American protectionism.

It was generally agreed that conflict between the United States and Japan would impose high costs on both countries that would spill over into Canada and Mexico, have a destabilizing effect on the international system, and undermine multilateral initiatives to address global problems such as environmental degradation. Thus policy-makers in North America and Japan have to be particularly concerned with finding ways of containing this conflict and promoting mutually beneficial relations.

Another issue underscored at the plenary session concerned the nature of Japan's role in North America. The U.S. economy relies heavily on Japanese investment. Canada and Mexico would like to attract more Japanese investment, partly to stimulate economic growth, and partly as a way of decreasing their dependence on the U.S. But several participants felt that the availability of Japanese funds for North America could diminish in the near future as global demand increases. For example, due to the dramatic changes that have taken place in the Soviet bloc in the past year, it is likely that there will be a strong demand for capital in several Eastern European countries. East Germany may absorb most of West Germany's surplus for some time. This would leave Japan as the principal source of investment capital for the rest of the world. It was generally agreed that Japan's interest in Siberia has greatly diminished, and that as long as the political situation in the Soviet Union is uncertain and its dispute with Japan over the northern islands remains unsettled, Japanese funds are unlikely to be diverted to the U.S.S.R. But Japan is interested in investments in other parts of the world and it is certain that global demand will increase far beyond Japan's capacity to respond to it.

In view of this, both Canada and Mexico have to develop strategies for making themselves attractive to Japanese investors. This will be difficult, however, because Japan is likely to be cautious until it is satisfied with the general direction of the changes taking place in North America. Moreover, Japan is certainly reluctant to take actions, such as increasing its presence in Canada and Mexico, that might upset the U.S. Thus further Japanese investment in Canada and Mexico may attend a clear sign of approval and intention from the United States government. It is worth noting that there is a potential political incentive for the U.S. here, insofar as this might be a way of maintaining a strong Japanese presence in North America, while defusing the American public's concern about growing Japanese influence and control in the U.S.

The problem of obtaining Japanese investment is of special importance to Mexico because its ability to do so may be dramatically affected by the free trade agreement currently being discussed with the U.S. Mexico hopes that the agreement, if reached, will make it more attractive to Japanese investors, especially since past efforts to interest Japan in Mexico have not been particularly successful. But Canada's experience in this regard is not promising—there has been no increase in Japanese investment in Canada since the Canada-U.S. Free Trade Agreement came into effect in January 1989. Thus an important issue for Mexican policy makers is how to ensure that the terms of North American integration encourage Japanese involvement, particularly in Mexico.

This may not be easy. While Mexico has great economic potential, it currently has one-tenth the productivity of its North American neighbors. The terms of North American integration have yet to be fully worked out, and while the general consensus was that integration is a desirable goal for all three countries, especially if it serves as a step towards more extensive global cooperation, no one saw it as an immediate solution to current economic woes. This is another incentive for Japanese investors to be cautious until the structure and intentions of North American integration have been clarified.

Again, the attitude of the U.S. government is likely to be decisive in this regard. One participant argued that while the Japanese economy is driven by decisions made in the private sector, the reverse is true in the U.S. Thus, for example, the potential of the Canada-U.S. Free Trade Agreement may be largely determined by U.S. government decisions, such as the decision to enact the Super 301 Section of the 1988 Omnibus Trade and Competitiveness Act after the Canada-U.S. agreement had been signed. In the case of a Mexico-U.S. free trade agreement, it is likely that investors will be quite restrained until the U.S. government's position has been made clear at both the Executive and Congressional levels.

Along this line, several participants emphasized the great importance of U.S. government decisions not only to the regional economy of North America, but also to the world economy. Of particular concern is the low savings rate of the United States. If competition for investment increases, and the U.S. continues to absorb vast sums of Japanese funds, other parts of the world, especially the less developed countries, are likely to suffer. And if Japanese funds begin to diminish due to changes in Japan's domestic situation or international investment strategy, the U.S. and its neighbors will suffer as well. To deal with this, the U.S. has to improve its savings rate, a task made difficult because of the public perception that this will require a high level of sacrifice. In any case, the consequences of U.S. and Japanese actions are so great that there is little room for error in the policy-making process.

The subject of Japan's relationship with North America is complex. The potential for conflict is high. Pressures imposed by third parties, especially in Eastern Europe and throughout the developing world, are likely to mount. And while there are strong grounds for promoting economic integration in North America, and for including Japan in this process, profound differences between the four countries make it difficult to map a clear route into the future. Nonetheless, the trend towards greater levels of integration was regarded as positive, especially if it is combined with policies to improve savings rates and structured to encourage multilateral forms of cooperation and integration in the future.

Section II

Japan and North America: The Economic Dimensions

H.E. (Ted) English

Introduction

The objective of this paper is to discuss existing and emerging economic relations between North American countries and Japan, with particular attention given to Mexican participation in North American free trade arrangements and trans-Pacific economic relations.

It is important to note at the outset that both Mexico and Japan have distinctive characteristics that are relevant to this discussion. Mexico is different from Japan and its North American neighbors in one major way—it is the only developing country, or near-NIE, in the group. This is likely to have a profound impact on the terms of any trade agreement negotiated by the U.S. and Mexico, with or without Canada. Also, it affects, and will continue to affect, economic relations between the U.S. and other advanced developing countries—especially those in East Asia and Latin America.

Japan is distinctive in another respect—it is the only country of the four that is a strong net creditor. Because attracting foreign investment is an essential element of the economic strategies of all three North American countries, especially Mexico, Japan's role as investor is central to any analysis of Japanese-North American economic relations.

The implications of these points will be developed with reference to three main features of Japan's economic relations with North America:

i) The importance of Japan's bilateral relations with Canada and the U.S.

ii) The aspects of the global context most likely to affect these relations in the future.

iii) The implications of i) and ii) for North American economic integration and for the role Japan and North America will play in global and broader regional arrangements, especially in the Pacific.

Japan's Bilateral Relations with Canada and the U.S.

The U.S. is the most important trading partner of both Canada and Mexico, accounting for 70 percent of Canadian trade and 62 percent of Mexican trade. Although Japan is the second most important trading partner of these two countries, it accounts for only six percent of Canadian trade and five percent of Mexican trade. (Other western Pacific trading partners are, incidentally, twice as important for Canada as for Mexico). Both Mexican and Canadian exports to Japan have heavily stressed primary products, though with a somewhat more diversified pattern for Canada.

U.S. trade relations with Japan scarcely need much review. Although Canada is the largest trading partner of the U.S., accounting for approximately 20 percent of U.S. trade, Japan is a relatively close second with over 15 percent, and Mexico is third, accounting for about ten percent of U.S. trade.

Turning to investment, Table II includes overall figures for foreign direct investment in the late 1980s.

Table II
Figures for Direct Investment
Relating to the United States, Japan and Canada
(billions of SDRs)

		1986	1988
U.S.	out	24.1	13.1
	in	28.7	43.5
Japan	out	12.2	25.5
	in	0.2	0.2
Canada	out	2.6	5.4
	in	1.1	2.9

Source: PECC Pacific Economic Outlook: 1990-1991

Investment flows from the U.S. are dominant in Mexico (over $20 billion) with the Japanese playing a modest role relative to their investment in the U.S. and Canada. However, Japanese investment in Mexico is estimated to have reached about $1.7 billion by 1988. There is interest in both Japan and the United States in new investment opportunities in Mexico, but there is also considerable caution in view of the major problems Mexico still has to overcome. Japanese investors are particularly sensitive to political risk analysis.

Debt financing shares of the U.S. and Japan in Mexico are much closer than investment flows—23 percent of Mexico's debt is the share of the United States and 20 percent is Japan's.

The future could be very different. The contours of future trade between North America and Asia, and of investment flows from Japan, can be conceptualized with reference to the general conditions of the world economy. According to the most recent *PECC Pacific Economic Outlook: 1990-1991*:

> The volume of world trade expanded by 7% in 1989 even though world output grew by only 3%.... All countries benefit from export growth of international trade. However, more open economies stand to benefit the most from this trade. Hence, the greater relative growth of the Pacific basin in 1989 can be attributed at least in part to the greater openness of the region's economies.

Looking ahead, the *Pacific Economic Outlook: 1990-1991* forecasts a decline in growth of real GNP in 1990 from 1989 levels for most Pacific economies, resulting in an average of 5.0 percent to 5.3 percent for members of PECC, with a return to a 5.2 percent average in 1991. Specific results for the economies most relevant to this discussion are presented in Table III.

Table III
Growth in Real GNP for PECC Economies

	1989 (%)	1990 (%)	1991 (%)
U.S.	3.0	2.5	2.8
Japan	5.1	4.3	3.1
Canada	2.9	1.9	1.4
Australia	4.9	0.8	3.2
China	3.9	5.4	5.9
Hong Kong	2.5	3.0	5.5
Korea	6.7	7.0	7.0
Taiwan	7.2	6.9	7.3
ASEAN (the largest five)	5.5 to 11.0	5.5 to 9.1	5.6 to 8.4
		(Philippines to Thailand)	

Source: PECC Pacific Economic Outlook: 1990-1991

Current and future trade growth are recorded in Table IV.

Table IV
Current and Expected Export Growth in Selected Pacific Countries
(%)

	1989	1990	1991
U.S.	11.1	8.6	9.0
Japan	12.2	4.9	4.9
Canada	-0.9	0.6	2.3
Australia	3.7	7.2	5.5
New Zealand	0.3	3.5	3.6
China	5.1	8.6	9.6
Hong Kong	10.2	5.7	8.4
Taiwan	4.9	3.3	3.9
Korea	-5.2	2.2	6.0
Indonesia	15.0	9.3	9.4
Malaysia	18.0	9.9	8.5
Philippines	11.7	8.1	9.1
Singapore	11.2	18.0	11.0
Thailand	28.7	20.9	20.0
Average Export Growth	9.0	7.9	7.7
Average Import Growth	15.2	9.4	7.4

Source: PECC Pacific Economic Outlook: 1990-1991

The message for the export sectors of the Pacific economies can be summarized as follows. 1989 was a good year with the U.S., Japan, Hong Kong and all ASEAN countries recording double digit growth, led by Thailand at 28.7 percent, Malaysia at 18.0 percent and Indonesia at 15.0 percent. Only Thailand and Singapore are expected to record export growth in excess of 10.0 percent in 1990 and 1991, but even in that year, it is predicted that the ASEAN countries, the U.S., China and Hong Kong will grow at 8.5 percent or above. The leaders of earlier years, Japan, Korea and Taiwan, will have to be satisfied with four to six percent growth rates. Australia expects to be in this group as well, while Canada and New Zealand will fall well below four percent. In Canada's case this is largely because of the single-minded concern over inflation, which it is estimated will still exceed the average of Pacific countries. Import growth for the region will, on the average, reach 7.4 percent compared with 9.4 percent for 1990.

These data suggest that the Western Pacific region as a whole is an economic motivator for the rest of the region and the world, especially for international trade. Furthermore, this role does not rest on Japan's performance alone, although even in its low year (1991) Japan is expected to increase imports at roughly the same rate as the United States.

The Multilateral and Pacific Regional Context

It is important to review the context in which the transformation of relationships in the North American economy is taking place. At the global level, two features stand out: the external debt burden that affects Mexico and many other Third World countries, especially in Latin America; and the macro-economic policy problem that has left the United States with a rapidly expanding international debt position.

The last phase of the Uruguay Round of GATT negotiations is another important aspect of the global context. Optimists are hoping for eleventh-hour concessions, but there is a growing concern that the Uruguay Round will fall short of its earlier ambitions and expectations. This is particularly serious for those who counted on the liberalization of agricultural trade and the phasing out of the Multi-Fibre Agreement, which constitutes the single most important barrier to the expansion of manufactured exports for the Third World. There have been suggestions, especially from the U.S., of focussing on a fallback position that would not address the concerns of developing countries. Instead, a kind of "GATT plus" solution, in which the round would be declared a success if it accommodated the priorities of the OECD countries, and left many primary products and textiles on the sidelines for future negotiations, would emerge. It is difficult to imagine a strategy less appropriate for the 1990s and especially for the developing countries of the Pacific basin.

Various regional developments are also relevant to this discussion. First, the Europe 1992 project, and its possible extension into Eastern Europe, are likely to have several consequences for any North American strategy. The most immediate effect will be the preoccupation of Europeans with their own challenges and opportunities. This may be one of the most important reasons for underachievement in the Uruguay Round. It is clearly a reason for diversion of investment away from the Third World, especially by the world's second largest creditor nation, Germany. North American businesses with well-developed connections in Eastern Europe may act in a similar way.

Second, in the Pacific, two possible groupings of countries (or economies) may evolve: one based in the Western Pacific, including Japan, Korea, China, Hong Kong, Taiwan, the ASEAN countries, Australia and New Zealand (13 in all); the other including Canada, the United States, Mexico, Peru and Chile, as well as the Western Pacific group. The institutional development of the larger group is more advanced. It includes two loosely-associated components—the Pacific Economic Cooperation Conference (PECC) and the Association for Pacific Economic Cooperation (APEC). PECC, which was initiated in 1980, is a tripartite group composed of government officials, businesspeople and academics from each country or economy. APEC operates through ministerial-level meetings that were initiated in 1989. Links between the task forces of PECC and the senior officials planning APEC meetings have been developing. Reports of PECC committees are channelled through a new PECC Secretariat in Singapore, as well as through national bureaucracies. PECC and APEC have 12 members in common. APEC currently excludes China and Taiwan because it is an intergovernmental group and Beijing will not agree to representation from the government in Taipei. Neither Hong Kong nor the three Latin American countries mentioned above are members of APEC, but all have recently been granted full membership in PECC.

Lest it be hastily concluded that Pacific cooperation is firmly established on a trans-Pacific basis, it should be stressed that important political and economic interests still lean toward Western Pacific cooperation. These are most pronounced in Australia and Japan, though attitudes in the ASEAN and even in Korea are affected by their perception of the weakness of the U.S. commitment to their development priorities. The harsh realities are: first, that Japan's rapid expansion of manufactured imports have benefited mainly the East Asian exporters, apparently for good economic reasons; and, second, Japanese investment continues to be directed by a preference for economically and politically stable environments. Since Japan, Taiwan, Hong Kong, and, in some sectors, several other countries, are important sources of direct investment and technology, it is important that arrangements agreed to in North America be both stabilizing and non-exclusive.

Japan's role in global and Pacific economic and political relations is discussed in the paper by Kenneth S. Courtis included in this volume. However, several aspects of Japan's role are worth mentioning here, as they bear on issues relevant to internal relations and trade groupings in North America.

Japanese trade with Canada and the U.S. is well established, but Japan's preoccupation in recent years has been with investment. Portfolio investment depends on economic and political stability and, therefore, will continue to be attracted to the U.S. and, one hopes, Canada. Direct investment is and will continue to be governed by the desire to respond to domestic market considerations ranging from the threat of protectionism (especially in the U.S.), to longer-term trends in exchange rates. It is mainly internal North American markets that are served by these investments. The same applies to Mexico, and its attractiveness to investors will be determined by access to natural resources, and by the opportunity to link Japanese manufacturing activities in Mexico to those in the U.S. via maquiladoras or other free trade arrangements that do not discriminate against Japanese businesses.

Finally, it should be noted that the maintenance and strengthening of U.S.-Japan relations through the Structural Imperatives Initiative and similar negotiation techniques must continue to produce positive results. For this to happen, it is necessary for both sides to stress that concessions must serve the long-term interests of the party making them and must not be sought merely as a means of keeping a "demandeur" from unilateral actions.

Mexico in North America and the Pacific

Mexico is, and for some time will remain, a country whose endowments are based on natural resources and labor values. The great changes underway that will benefit Mexico are the growing capacity of its labor force to compete in the world's markets, and the decision of its government to place a priority on trade-related development. The former is being achieved through the improvement of skills through education and through improved management, based in part on the development of the maquiladora plants. Mexico's comparative advantages will, therefore, continue to favour resource- and labor-intensive exports. Although Mexico's resource wealth will contribute significantly to its ability to further upgrade skills, it is handicapped in the international market for labor-intensive products whenever it has to compete with products from East Asian countries that are less capable of resource exports. A free trade area integrating Mexico with the United States (and perhaps Canada) would help to shift Mexican imports towards more labor-intensive processed or manufactured goods, accentuating the maquiladora effect already evident in Mexican trade statistics. Such an arrangement would have a much greater trade-diversion effect than the Canada-U.S. Free Trade Agreement (FTA) is likely to have, since it would partly counteract the competitive strength of Korea and Taiwan and severely limit the scope of Southeast Asian competitors, such as Thailand and Indonesia. These countries, especially Indonesia, have the same mix of resource wealth and low wages as does Mexico and would be most directly affected by the discriminatory effects of a North American free trade zone.

In contrast, the Canada-U.S. Free Trade Agreement is unlikely to have a significant trade diversion effect. Since wage levels are similar in the U.S. and Canada, the main benefits of the FTA are the economies of scale and competition-enhancing effects on unit costs in particular plants and product lines, and the hard-to-measure (especially for small- and medium-sized countries) and dynamic consequences of large market units. (In terms of GNP, Canada is less than one-tenth the size of the U.S. and Mexico a little more than half the size of Canada.)

Mexico's problems in becoming more competitive are clear. They include its debt, rapid population growth and the related effects of sustained inequalities. The necessity of attracting foreign investment and, from a political perspective, improving the quality of life for the least advantaged sectors of Mexican society, underlies the outward-oriented trade and development policies of President Salinas. The idea of a Mexico-U.S. free trade agreement is appealing as the easiest-to-negotiate basis for achieving commitment to and early results for that development strategy in the next four years.

It is not clear, however, that this policy will bear all the fruit expected of it, or that it is wise to make it too dominant a priority, for two reasons. First, this would be the first substantial free trade agreement between countries at such different levels of economic development and living standards. Second, other international interests important to both the U.S. and Mexico might not be well served by too heavy an emphasis on this as a sole or dominant strategy.

When two countries at very different levels of development contemplate a free trade arrangement, they have to recognize certain asymmetries in social priorities. For example, public or private intervention will be a priority for the less industrially-advanced partner to compensate for its lack of management and labor skills, and to remedy infrastructural deficiencies. A longer transition period for the removal of trade barriers by the less developed partner may also be desirable. Since labor-intensive industry will constitute the main comparative advantage of the less wealthy country, the wealthy partner will have to be prepared to accept significant adjustments in certain sectors. A request for partial or complete exemption from the agreement for such sectors is not unlikely, though obviously regrettable.[1]

Both service trade and capital movement will prove to be more difficult to liberalize than in arrangements between states at similar development levels, but neither are strictly necessary to satisfy GATT requirements pertaining to free trade agreements. However, it seems likely that the movement of labor across the border, already large, will be a subject of rather high priority. Some analysts perceive the freer movement of goods and the related development of Mexican employment opportunities as a way of reducing unofficial migration. Finally, with regard to capital movement, given the Mexican government's apparent willingness to receive foreign investment, it would seem desirable to make investment from all sources equally welcome, combining the stability effects of a formal free trade agreement with the promise of security for new investment as well as debt reductions.

Since all North American countries are net debtors, all have a common interest in improved access for goods and service exports to dynamic overseas markets. Among these, the Western Pacific markets are prime prospects. Both Canada and the U.S. already have more trans-Pacific trade than trans-Atlantic. It is thus in the interest of all three countries to take an active role in cooperating with other Pacific countries through PECC and the forthcoming APEC Trade Ministers' Meetings (scheduled for September and December 1990) to promote a liberal outcome for the Uruguay Round. If the round fails to achieve an adequate increase in trade liberalization, then the Pacific countries might be well advised to consider particular conditional MFN arrangements, open to other GATT countries. For example, a Pacific-based Multi-Fibre Trade Liberalization Plan might involve the five most developed countries of the region in an agreement to phase out quotas over a specified period (or a commitment to substantially increased imports) in exchange for concessions in the same sectors by the other countries of the region. This could begin with tariff binding, followed by phasing out of trade barriers, especially on capital-intensive primary textiles.

Similar regional agreements related to selected service sectors, intellectual property commitments, and rules governing subsidy, countervail and anti-dumping practices might also be explored. All of this is based on the assumptions that the commitment of PECC countries, including its newest members, to trade-oriented development, would motivate them to go beyond what GATT can achieve this year, and would set an example that other GATT members might in due course follow.

Conclusion

The main conclusion of this analysis is that the North American countries should avoid the kind of bloc-building that discriminates against its most dynamic and like-minded trading partners. The most immediate opportunities lie in building upon North American cooperation with other Pacific countries. It is worth remembering that initiatives taken in this region will represent nearly 40 percent of world trade without the participation of Mexico, Peru and Chile. For most of the current PECC members the region accounts for between 60 and 80 percent of their trade; for the United States, the figure is approximately 54 percent. The latter figure would rise to over 60 percent if Mexico-U.S. trade were included. Under these conditions, economic relations between North America and Asia-Pacific will be enhanced as long as the economic and political complementarity of the two regions is recognized and pursued.

Notes

1. In the agreement between the European Community and its African and other ex-colonies, free entry for new materials to European markets is permitted, but not for processed natural products, which would be the most likely manufactured exports from many of those territories.

Panel Discussion

Clark Reynolds

Mexico's condition, as I think everybody is aware, has been one of stagnation for eight years, with a significant decline in wages and income for the mass of the working population. So one is not starting with a basically healthy economy. One is starting with a very bad situation on the Mexican side. In a sense, the price has been paid for restructuring and has been exacerbated by the social costs of eight years of stagnation. I will not go into why the stagnation took place, but it had a lot to do with an economic model that is now outmoded in Mexico, a model that supported import-substituting industrialization well past the time when its advantages were exhausted.

The theoretical framework that I am using for this discussion relates to some of Ted English's comments. What we have is an evolution of the Mexican economy, based on what we might call "resource rents" or taking the return from raw materials and primary products and using it to subsidize the growth of import-competing industries. From resource rents the country went to what I call "protection rent-seeking investment."

Nevertheless, from 1978 to 1981, the economy grew significantly. It was, however, growth based on taking the rents from petroleum and other natural resources and using them to subsidize the growth of protected import-substituting industries. When the economy stopped growing in 1982, Mexico had experienced four years of compound eight percent growth, (a 40 percent plus increase in productive capability), but much of that increase was in the wrong direction from the point of view of efficient resource allocation or international competitiveness.

Mexico's problem is two-fold. First, it needs to recover from eight years of stagnation; and second, it needs to restructure its economy as it recovers. Now this is a double problem of major proportions which has severe social and political implications when you consider that most of the work force has experienced a major decline in real wages. Mexico is not starting from zero; it is starting from minus 1,000.

The social problems include the need to work more hours to offset falling real wages; the need for many in the household to work two or three jobs, including increasing recourse to the informal sector; cutbacks in consumer durable purchases and investment in human capital (education); deterioration in living conditions; shifts in the market basket (for example, from wheat bread back to tortillas, from meat and fruit consumption and other higher cost consumables to lower cost consumables); and deterioration in health conditions. All of these are the dead weight cost of eight years of stagnation. It is impressive that a country can survive eight years of declining real wages without exploding. And although there has been some political liberalization, it is still not what one would call a full democracy. So we are looking at an economy that is not well and at a society that is reaching the limit of its ability to adjust.

I point this out because this realization on the part of the United States is a very important element in its receptivity to Mexico's overtures to have a free trade agreement. The security of the United States is intimately linked to the security of Mexico, and the security of Mexico is intimately linked to the viability of its economy and the ability of its population to share in the fruits of economic growth.

If one looks at alternative scenarios for Mexico's recovery, restructuring and growth, there are several possibilities including an autarchic model and an East Asian linkage model. I think Owizawa asked, "Can Mexico follow the Asian geese, which follow Japan?" This is improbable. If the Mexican goose decided to follow the Asian geese it would be a long time before it even caught up with the flock, much less found a position in the second or third V-formation. Basically, whether it likes it or not, the Mexican goose has to fly with the North American formation. There does not seem to be an alternative for Mexico except to find its opening in the direction of the North American economy, beginning with the United States.

Now is this a "black hole" phenomenon (borrowing a term from Shumpei Kumon) from the point of view of the United States, and poor Canada, which is sort of stuck with Mexico because it has already signed an agreement with the U.S.? Well, as I said this morning, I do not think that is true at all because we have already seen a tremendous vitality in the Mexican economy. If you look at the statistics, you are really seeing the average of two counter trends. One trend is the result of restructuring that comes with liberalization, meaning that a number of industries and job classifications are declining. Specifically, those industries which depended on protection rents and subsidies are going to have negative yields and will decline when the support is taken away. The positive trend—which will eventually dominate—reflects the emergence of new industries, new product lines, and new regions that are growing in the direction of competitiveness.

Many here will support me when I say that given the proper machinery and equipment, the physical productivity of labor in Mexico in a number of industries, not just maquiladoras, but others such as the auto and auto parts sector, is higher than the productivity of labor in many parts of the United States, Canada and East Asia. Despite these physical productivity levels, the value product of Mexican labor remains low. The reason is that when the offer price of labor is only four or five dollars a day for workers coming out of agriculture and urban underemployment, labor is employed until its value product drops down to four or five dollars of the margin. If the marginal value product remains at eight dollars while wages are four dollars, one has not employed enough labor. On that basis there is a false productivity calculation in the low value added per worker data. As the labor market in Mexico tightens through integration with the U.S. and Canada, the value product of labor will rise accordingly.

There is a second false dimension in the present low value product of Mexican labor that is related to the exchange rate. At least until recently, because of the need for foreign exchange to service the debt, the real exchange rate was based on a peso that was undervalued in terms of purchasing power parity. The exchange rate was influenced by the need to obtain financial resources to service the debt. So the value product of labor is distorted, first, by the very abundant supply of labor in Mexico and, second, by an exchange rate which is not a long-term rate.

I am not criticizing such distortions—they are market phenomena—but they do not represent a long-term equilibrium. What this means is that Mexico has latent productivity that is potentially very competitive. It has money wages and real wages that are very low comparatively, so there exists an opportunity to earn a new form of rent. Instead of the old protection rents, Mexico can earn profits based on what might be called "market penetration rents" or gains from trade.

Such rents, which Richard Lipsey terms "income gains," are the result of a dynamic process. Income gains result from bringing Mexico's slack labor more fully into the North American economy. These income gains could amount to a very large sum. If you figure that the average productivity in Mexico is $1,900 a year and the average productivity in output per worker in the United States and Canada is $19,000 a year, this gives you an idea of the order of magnitude. We have done a simple modelling of this which suggests that over a decade the current value of a trillion dollars in gains would accrue from bringing Mexico fully into the North American economy. These gains would exceed the negative substitution effects from the incorporation of Mexico and the cost of adjustment, but they would not happen immediately. And as we heard this morning, many investors will be very, very cautious about rolling the dice on income gains from integration, until the rules of the game are more clearly established. On the other hand, if you wanted to bet on profitability, there is little question in my mind that, subject to political stability and stable rules of the game, these gains are extremely attractive. The only way, however, that there will not be costs to some sectors, regions and income groups associated with these gains (such as adjustment costs in the United States) is if the U.S. economy recovers and grows as well.

There will certainly be convergence in productivity from North American integration and there are two ways it could come about. The first is through productivity in Mexico (and Canada) rising towards the U.S. level, and the second is through U.S. productivity declining toward the Mexican level. The present process of "silent integration" is already working in that direction. So the only way to have stability and convergence in North America is for the U.S. and Canada to grow faster than they are growing right now because we have to keep our labor markets tight as Mexico's grows. Mexico's market will grow faster, but ours have to grow enough so that we will have a growing demand for labor and thus be able to keep the market relatively tight.

This means there is no way around the policy transformation in the United States that we heard about this morning. Linking the three economies without that transformation in the United States would lead to the United States declining in order to permit Mexican gains. In this scenario, the gains would occur and a lot of capital and labor would share in those gains, but the U.S. as a whole would suffer. So the U.S. has to grow in order to make sure that gains are distributed in a socially and politically stable way.

What does this mean? It means basically that the model we are looking at is a dynamic model in which capital flows into Mexico in response to the allure of a significant share of the profits from trade. Mexican investment adds to the driving force in response to a widening regional market. If the U.S. is to grow as fast as it must in order to keep its own labor market tight, it has to have access to the Mexican market as well. Now, it is true we have capital scarcity in the U.S. But Mexico only needs foreign investment of about nine or ten billion dollars a year. Right now it is getting about half of that. Four billion a year is not much additional investment from the point of view of the United States. It is certainly within the scope of U.S. savings and investment capabilities to participate in Mexico's recovery and the recuperation of Mexican capital. Indeed that is one of the advantages of starting at such a low level of GNP. But over time, naturally, there will have to be significant capital flows toward Mexico, calling for rising rates of savings in both countries.

In defining an essential role for Japan in this process, we have to consider the opportunities for joint benefits. This cooperation will entail capital flows, technology transfers, and the opening of the Asia Pacific market to North American economies while trying to minimize trade diversion. I agree with Ted English that some trade diversion is bound to happen at the outset. In part it is a response to the removal of market barriers in North America. For example, when an Asian economy such as Japan or South Korea develops, it moves production offshore in an increasing number of activities that are no longer competitive in terms of dynamic comparative advantage. A rolling restructuring results, which is part of the process of growth. Trade is a constantly shifting phenomenon. I think that we are going to see a speeding up of restructuring in Asia as part of the North American integration process. It is a distant early warning of the effects of bringing broader Third World participation into the international market. While such a process could be called "trade diversion" by raw statistical measures, it is in fact the evolution that arises from efficient restructuring. From the data, it appears that some of the Asian NIEs will lose market shares to Mexico in labor intensive products. But that is a good thing, if the losers have offsetting gains in other areas. However this will lead to countervailing pressures, which Japan will obviously be concerned about, because it cannot go into Mexico and North America blindly, at the expense of its legitimate Asian partners. Only when viewed in the broader framework of the Pacific Rim, does one see North American integration including Mexico as a stage in the process of greater region-wide liberalization. The North American countries are not necessarily setting up a counterforce to Europe, but rather a partnership in which one moves together first in North America and then within the Pacific Rim and finally on a broader global level, though certainly there will be stresses and strains in the short run.

The final kind of rent seeking in which one hopes Mexico will be increasingly able to participate, is what I call "innovation rent-seeking." This is the return from product and process innovation. Certain Mexican industries, some of which are represented here, are already earning innovation rents. The Third World will be increasingly involved in this process, even though most innovation rent-seeking is still taking place largely among the advanced industrial countries. I think this involvement is advantageous, because if the Third World does not participate in innovation rent-seeking, which will eventually take the place of resource rents, then it might indeed become a "black hole." Bringing Mexico into North America is a gamble, a risky attempt to avoid a "black hole" by bridging the economies of North and South in the Western hemisphere, just as is occurring in the Western part of the Pacific Rim. By bringing Japan and the Asian NIEs into the process, we can build on the proven ability of Mexico to become globally competitive and propel ourselves toward a more open and dynamic international economy.

Gabriel Szekely

I would like to comment initially on one of the points made by Ted English with which I fully agree and which is not sufficiently appreciated in Mexico, especially among those who favor the idea of a free trade agreement. It is not clear, as he says, that free trade will bear all the fruits expected of it. I share his concerns that Mexico's decision to proceed with trade negotiations, which is a political decision as well as an economic decision, is not receiving enough attention by those who could make a contribution in realistically explaining its potential impact. Certainly the portrayal of this policy by the government as one that will quickly solve a lot of problems in Mexico is not helping either.

I sound that cautionary note in spite of the fact that I include myself among those who, long before the government publicly acknowledged it was beginning to negotiate with the United States, had argued publicly in favor of a free trade agreement with the United States. I am going to explain why I have argued for this idea, and I will do so in the context of briefly analyzing the trilateral relationship that involves the notion that when considering Mexico's relationship with the United States, it is no longer possible to leave Japan out.

How is this trilateral relationship viewed from each of these three countries? The first thing that comes to mind is, of course, that there are different groups with different interpretations in each of the three countries. So we are getting into a more complicated set of questions, but I am going to try to simplify it for the purpose of this presentation.

For the U.S. government, it has been helpful to have Japan lending money to Mexico in substantial amounts, especially over the last five years. During the same period, the U.S. government has mostly provided government guarantees in renegotiations of the Mexican debt. It is also fine to have direct foreign investment from Japan flowing into Mexico, as long as, when we are talking about natural resource industries, it does not exclude third party access to the increased production these investments bring about.

Let me clarify what I have in mind. For example, if the $500 million loan to Pemex to expand facilities to export more oil from the Pacific to East Asia, particularly Japan, were to mean restricted access for exports to other countries, including the United States, that would cause a problem. But since this has not been the case so far, it is, from a U.S. perspective, a convenient flow of resources from Japan to Mexico.

For a number of reasons American unions have opposed investment in the maquiladoras. Their opposition has been particularly focussed on Japanese investments because they have been concentrated in industries where Japanese producers successfully displace U.S. producers. Some intellectuals have also started to be concerned about what they see as a potential challenge to U.S. interests. So there is a diversity of opinion in the United States about this trilateral relationship.

Mexico originally held a strategic importance for Japanese interests because of its oil. This perception was not unique to Japan, however. One only needs to remember how Mexico was perceived in the United States in the mid-1970s, in the midst of the oil crisis. When I came to the United States as a graduate student, I remember being informed that I came from one of the best countries on earth. Notably, this is not the same kind of language I have been listening to in the last five years that I have lived in California.

What the Japanese government is doing in Mexico by increasing its economic presence is helping a key U.S. ally which is in trouble, at a time when the United States cannot provide the resources.

Turning to the Japanese corporate sector, the story changes drastically. I do not think I have seen bankers from any other industrialized country who are more irritated about the debt issue than the Japanese are. There are also the not-so-happy experiences of joint ventures involving Japanese multinationals and Mexican government agencies, where the balance is frankly, not very positive. The situation changes somewhat when one looks at other Japanese investments in Mexico where companies have managed to reorient their thinking from an original strategy of simply gaining access to the domestic market to focussing on world markets. The most important example is Nissan which is poised to begin investments of an additional one billion dollars in Mexico. Nissan accounts for one-half the total amount of Japanese manufacturing investments in Mexico. Through each new investment, it is positioning itself to export more to the United States, to become the key exporter of Nissan to Latin America, and to begin to export, very importantly, to Japan itself. So there are Japanese business interests which have managed to survive the domestic economic crisis and are now in a favorable situation. Nissan is now the number one automobile seller in the Mexican market. And then, of course, there are the maquiladoras, which are a success story for Japanese business interests. This is, in brief, a map of how Japanese interests perceive Mexico and their relationship with the United States.

Finally, there is Mexico itself, for which Japan is obviously a key source of economic resources. In fact, it is the second most important source of resources in Mexico, second only to the U.S. in any area, including investment in maquiladoras. In the financial area, it is striking to me that Japan, having played such an important role in Mexico, continues to be left out of the discussions of most people on the subject of its external debt. The fact is that about 16 billion out of 32 billion dollars that Japanese commercial banks have lent to the region up to this year, have been placed in Mexico. That 16 billion compares with approximately 25 to 27 billion from U.S. commercial banks. These, by the way, are only estimates because such figures are difficult to obtain.

Now, if the scenario for the future is the one that Kenneth Courtis presented this morning, that is, one of increasing competition among blocs, then Mexico should develop a two-track international strategy to protect its national interests in the long term. The first track is formally joining the North American economy, which to me means, negotiating a free trade agreement with the United States and, sooner rather than later, trying to develop trilateral institutions that include Canada as well. I do not see that it makes sense to have Presidents Bush and Salinas meet in Washington and the next day have the Mexican Trade Minister fly to Ottawa very quickly to report on what happened in that meeting. I think that we would be better off having the three countries sit at the same negotiating table at some point.

The second track is to maintain a policy of cultivating economic relations with Japan to the greatest degree possible. As I tried to argue this morning, this is not an easy strategy to follow for a number of reasons. We have very limited experience in this area. Our foreign policy for many decades was largely limited to questions of ensuring that certain principles that were very important to us historically would be respected and would be followed to the letter. Now we have to make some strategic choices where there is a lot of uncertainty, and where no one really has extensive experience in dealing with the actors that we now have to deal with. It is a challenge that I believe is largely imposed on us by changing circumstances in an international system that, just a year ago, no one knew would be as we see it today. But we have to face up to that challenge. I feel that we should have a more confident. self-assertive attitude with respect to our ability to face that challenge successfully than has been suggested by many of my colleagues. It is important that we disagree, however, because there is now an opportunity to have a debate which would not have taken place just a few years ago. And I think we should welcome that.

I do not think that if we look at the experience of Europe in particular, we necessarily face threats to our national identity or to our sovereignty. At the same time, by negotiating a free trade agreement, we are not going to receive all the benefits that in theory we could receive. It will depend on our ability to organize ourselves to think through very carefully the negotiations that we will initiate and to have a very specific idea of what we want to achieve in each specific case.

To conclude, there are two worst possible scenarios that I can envision for the future. One relates to this morning's discussion. Should U.S.-Japanese tensions escalate, Mexico will be in a difficult or no-win situation, since the United States and Japan are its main sources of economic resources. If it disregards Japanese interests, it will be alienating that country. If it looks the other way when the U.S. asks for its support, that will probably be interpreted as not being loyal to the United States.

That is one of the two nightmares, if you like, of someone who is thinking of these issues. The other is that the negotiations for a free trade agreement involving Mexico and the U.S. are initiated and then fail. That would be another nightmare because I think that the political costs of such failure would be excessively high and it would take many, many years before Mexico and the United States would be able to put their relationship on the right footing again.

To a large degree this process of increasing economic integration, in which the free trade agreement is only one step, is much beyond the control of any government. It has occurred largely as a result of social forces and the market (although it is desirable to have governments regulate this process to some degree at least). It is for these reasons, along with Mexico's need to develop an international strategy, that I think Mexicans should support the process of negotiations with constructive proposals in order that we come up with the best agreement possible, and then invite Canada to join the process.

Kiyoaki Kikuchi

Let me start with a comment on the views expressed by Daniel Okimoto. He enumerated five roles for Japan. But I think it was taken for granted, which is why he did not mention it, that the most important role Japan is going to play is to continue to be the greatest absorber of imports, not only from Asian NIEs and the ASEAN, but also from other parts of the world. This is going to replace, very imperfectly of course, the role that the United States market has been playing in the past as a great absorber of primary and manufactured goods.

With regard to the investment relationship between Japan on the one hand and the United States, Canada and Mexico I do not think I have to go into detail, as Ted English has covered most of what I would point out, except to say that our trade and investment relationship with the United States is very different from our relations with Canada and even more so with Mexico. It is common knowledge that Japan has been running a trade surplus vis-à-vis the United States, and a trade deficit with Canada and, until very recently, with Mexico.

Also, you are aware of all the questions Japan has with regard to the United States, all the talk about friction and so on, which I am going to touch upon later. But with Canada, my experience is that it has always wanted to export more from its manufacturing sector to Japan and that it is always competing with the United States in the export of its natural resources to Japan. Mexico has been wanting to get an assurance of a stable, long-term sales contract for the export of its petroleum to Japan at a good price, together with Japanese financing. But other than that, Mexico has no problem with Japan because Japan has been its best customer for silver and other mineral resources (particularly copper concentrates), salt—half of our salt input comes from Mexico—and raw cotton. Also we are the greatest provider of financial resources, both private and public. As Gabriel Szekely said, Japanese banks are the second largest lender to Mexico. I think his figures are right. U.S. banks have about $56 billion outstanding credit and Japanese banks have about one-half of that, although that figure may be low because of the accumulating interest. I would like to add that in connection with the application of the Brady Plan to Mexico, Japan was the only country which would combine operations by the private banks with Japanese ODA. No other country has done this, so I think we are a bit proud of that.

Now on investment, naturally we have the problem of so-called over-investment in the United States. Personally, I do not believe in the talk about investment friction between Japan and the United States. You must consider that so many of the states of the United States are stationing representatives in Tokyo, inviting Japanese investment, and competing with each other. Incidentally, with regard to all the talk about Japanese real estate purchases in the U.S., it takes a seller to buy. There are lots of U.S. real estate people roaming about in Tokyo trying to find purchasers. The newspapers are misleading, really misleading in this regard, because it takes two to strike a bargain. The problem in Japan is that there are so few people who want to sell either their real estate or their companies—that is the whole trouble. There are no sellers in Japan, in part because it is a shame for Japanese businesspeople to sell their companies. The recent trend of Japan's direct investment in North America, as I understand it from the White Paper on foreign commerce just published in Japan, is that direct investment in manufacturing plant has peaked.

Of course, there is a hue and cry against Japan's buying into the U.S. and even the Japanese mass media echoes this kind of sentiment with its usual anti-business bias. But personally, I do not believe in this kind of thing for the reason I mentioned, that most of the 50 states of the U.S. have stationed representatives in Japan. Moreover, President Reagan and President Bush have both issued very clear statements that they would like to see the U.S. welcome Japanese investment with a voice loud and clear. So the question is, which information does one use—official or journalistic?

Now Japanese investment in maquiladoras in Mexico has grown to such an extent that it is causing the resentment of American businesspeople who see products made in maquiladoras by Japanese firms streaming into the U.S. market. But I think this is sheer nonsense because that is exactly what maquiladoras are all about. Of course, I am not unaware of the sensitivity to foreign investment in cultural industries, particularly in Canada—it is a rather celebrated subject between the United States and Canada. We Japanese people are keenly aware of this, having learned it from our own experiences with the Republic of Korea, which still prohibits the import of Japanese films. You may not be aware that Japanese singers who perform in Korea are not allowed to sing in Japanese. They have to sing either in Korean or English. Very strange! So we are sympathetic in this regard.

I really believe in the maquiladoras system. We heard that Japan has about 60 to 70 firms located in maquiladoras, a small number compared with the 2000 foreign firms apparently located there.

Another thing I want to say is that now there are many Japanese firms, including my own, the Matsushita Electric Industrial Company Limited, that have considered targeting the entire North American market as one market and networking our manufacturing plants and sales outlets located all over the U.S., Canada and Mexico.

Now I come to my main theme, the Canada-U.S. Free Trade Agreement and the possibility of a forthcoming Mexico-U.S. free trade agreement. The Free Trade Agreement between the United States and Canada has been in place for 18 months or so, but Mr. John Crosbie, the International Trade Minister of Canada, says it is too early to assess the impact of this agreement. While it is premature to assess the whole impact of the free trade agreement between the U.S. and Canada, one can say that it certainly has stimulated the neighboring countries of the United States, particularly Mexico, to search for a way to expand trade with, and invite investment from, the United States. I was really amazed that Mexico finally began negotiations with the United States on a free trade agreement. They had three so-called "Frameworks of Consultation" on trade and investment relations in November 1987, but I was truly surprised at how this turnabout in Mexico developed, especially knowing the atmosphere prevailing in Mexico.

In my time in Mexico it was almost anathema for Mexico to talk about this kind of thing. Mexico even tried to limit its exports of oil to the United States to no more than 50 percent of its total exports. I do not know what brought about this change. I would call it almost a sea change, a dramatic change. But maybe, as I said, it is that Mexico has been stimulated by the Canada-U.S. Free Trade Agreement. I was told by the Mexican Ambassador in Tokyo that the Mexican people do not particularly want such an agreement, but believe it to be absolutely necessary. In that belief, they have been convinced by the performance of President Salinas de Gortari. People now believe in the President's leadership. I tend to agree, because otherwise Mexico would still be believing that any agreement with the United States would be to its disadvantage and Mexican sovereignty would be swamped by the colossus to the north.

I listened to President Salinas when he came to Tokyo to talk about this initiative, but still I am not sure how far Mexico is prepared to go. Is it prepared to go as far as the Canada-U.S. Free Trade Agreement? I know there are some lingering reservations on the part of Mexican policy-makers that perhaps they can go just as far as agreeing with the United States to free trade on a sector by sector basis. We have seen indications of this in this session. If Mexico does not go as far as Canada has, then the arrangement will not mean very much, for the only motivation for Mexico to enter this kind of agreement is, like Canada, to get secure and increased access to the U.S. market without being bothered by the harassment of the U.S. Congress.

One of the greatest merits of a free trade agreement with the United States is that it is an agreement which should be ratified by the U.S. Congress. The U.S. Congress, by ratifying it, will be bound by it. I think one of the aims of the Canadian government was that instead of solving their problems piece by piece with countervailing duties, subsidies, and antidumping laws, they wanted an overall agreement. Of course, somebody mentioned that the U.S. Congress went back on this agreement by enacting the Super 301 Section of the Omnibus Trade and Competitiveness Act (1988), and that is certainly true, but still I think it is important to have this kind of contractual relationship with the U.S. Congress. The U.S. Congress has never ratified the GATT—not many people know this—so they do not feel obligated to abide by the GATT. It is only after specific authority is given by Congress to the U.S. administration that U.S. administration can enter into trade negotiations. By negotiations I mean give and take, not just taking, like between the U.S. and Japan. With regard to the 1988 Omnibus Act, the U.S. government has been negotiating with other countries without any authority. Can one believe in it? I mention this because when I was Deputy Foreign Minister in charge of the Economic Summit I experienced something similar with the European Community. When EC representatives come to Tokyo they ask Japan to do this and that, and I always ask, do you have a mandate from the Council of Ministers? Invariably they have no mandate.

Now I would like to talk about how Japan would fit into this triangle with U.S.-Canada and U.S.-Mexico. Once these two free trade agreements come into force, what would Japan do? My idea, my pet idea, is a kind of fantasy, but I have been advocating it since the Canada-U.S. Free Trade Agreement came into force. I originally proposed that Japan offer to join the Canada-U.S. Free Trade Agreement, because the U.S. and Canadian governments professed that this agreement was open-ended and non-exclusionary. So why not have Japan join the Canada-U.S. Free Trade Agreement? But the process is going faster than I expected and we now have the possibility of a Mexico-U.S. free trade agreement. When finally this triangle is formed, I think Japan should offer to join the triangle, so that you have what Gabriel Szekely was just mentioning, a sort of quadrilateral relationship. I called it a fantasy, but my point is that the reason Canada went into this agreement with the United States, and Mexico is seeking to negotiate an agreement with the United States, is that their trade with the United States is so important. That is also true with Japan. Our main objective would be the same as that of the Canadians and Mexicans: to enter a contractual agreement with the United States government, particularly with the U.S. Congress, so as to obligate the U.S. Congress not to legislate unilaterally in any infringement of this free trade agreement. And if everything goes very well, then we will have a North Pacific free trade area and through that, of course, other parts of the region—Taiwan, Korea—can join later. However, I am not envisaging the participation of continental China or the maritime provinces of the Soviet Union.

Finally, I think what I have left to refer to in terms of Japan's role in this whole situation is that internally Japan should try to relax or eliminate altogether the numerous controls and regulations of the government, central or local, and of the trade associations and so on. For our own sake we are already embarking upon this power structure reform—our perestroika. All kinds of depressing things are being talked about in Japan, such as a declining yen, the dwindling current account surplus, the chronic deficit of our basic account as opposed to the current account or the trade account, a declining savings rate, an aging population, a more

Asia-minded young generation and, above all, a so-called bubble economy that is based upon exorbitant land prices and so on. Under these circumstances it may be thought that the sun will set on Japan. But I do not think this will be the case. I am optimistic about things and I believe that after the Structural Impediments Initiative talks, the normalization of the Japanese distribution system and the liberalization of the service industry will not damage the boom economy but, after an adjustment period, will give it a further boost and bring a higher, better quality of life.

I think what Japan should do first and foremost is deregulate. Then, as the United States assisted in the reconstruction of the world economy after the Second World War and contributed to the development of the prosperity of the developed and developing countries alike by absorbing their products freely and transferring its savings to the outside world, Japan should play more of a senior role in the last decade of the 20th century. I think that even though Japan's orientation in foreign trade and investment will most likely continue to be tilted toward the North American market, this tendency has been attenuating recently. But still, the general orientation is there—the U.S. market is the greatest market of the world and Canada and Mexico are attractive alternative sources of products, particularly of oil and natural gas. Japan has a great stake in the future development of these three North American nations and I think trade and investment between North America and Japan have great potential. At present, there are favorable conditions surrounding our four nations: first, the orthodox free trade stance of the President Bush administration, as opposed to certain protectionist tendencies in the U.S. Congress; second, the overtures of the U.S. to both the North and the South for free trade; third, the reciprocating attitudes of the Canadian and Mexican governments to this U.S. initiative; and, last but not least, Japan's continuing efforts for liberalization and deregulation and its pursuit of economic structural adjustment, all of which will prepare it for it eventual integration within the world economy. This is indeed the surest way of avoiding the pitfall of the emergence of a Fortress America, not to mention a Fortress North America.

Plenary Session Summary

Issues raised during the second plenary session ranged from specific comments about the problems Mexico faces in negotiating a free trade agreement with the U.S., to general observations about the relationship between a North American trade bloc and the rest of the world, to suggestions of topics that merit further study and discussion.

The bulk of the discussion focussed on Mexico. One participant argued that the assertion that real wages in Mexico have recently declined significantly was misleading as it was based on an analysis of Mexico's minimum wage. This is no longer a useful reference point because even the lowest paid sectors of Mexican society tend to earn much more than minimum wage. Mexico's economic situation is not as dire as this analysis suggests, and Mexico offers more to potential investors than simply cheap labor. In today's world, trade advantages have to be engineered, and investors who can bring technology and management skills with them can be successful in many sectors. The potential is virtually unlimited and Mexico has already established an excellent track record in the manufacture of goods such as auto parts and glass products.

In spite of its potential, Mexico has experienced difficulties in attracting foreign investment. Will a free trade agreement with the U.S. stimulate investment in Mexico? Mexicans are divided on whether such an agreement is desirable, why it might be desirable, and what form it should take. The government has not helped to resolve these disagreements, possibly because its motivations for pursuing a free trade agreement are based on short-term needs rather than long-term benefits. A short time ago the government was opposed to a comprehensive trade agreement with the U.S. Its change of heart was due to a sudden cash flow problem and a growing current account deficit. It hoped that by negotiating a free trade agreement it would attract foreign investors interested in secure access to the U.S. market.

The sudden change in policy by the Mexican government has created the impression in Mexico that a free trade agreement would not require any new concessions, as it would essentially be an act of reciprocity on the part of the U.S. for actions unilaterally taken by Mexico in the past. If this is actually what the Mexican government pursues, then the agreement may not have the desired effect. To attract investment will require that Mexico make concessions and commit itself to certain changes. To admit this, however, might result in opposition in Mexico. Thus the government faces a dilemma: the sort of agreement likely to be supported in Mexico may not be acceptable to the U.S. or attractive to foreign investors.

The government needs to clarify its objectives. Confusion is evident, for example, in regard to which countries it believes would invest in Mexico if a trade agreement with the U.S. was signed. Mexico needs to address the difficult issues of what it hopes to attain, what the U.S. will accept, and what its own people will support.

This confusion, it was noted, may not be limited to Mexico. At least in terms of attracting foreign investment, all three countries have yet to identify satisfactory strategies.

Mexico's problems are not limited to confusion about what it wants to achieve and what it is likely to achieve in a free trade agreement with the U.S. The Canada-U.S. Free Trade Agreement took 27 months to negotiate, with 60 to 70 Canadians working full-time in Washington. This in spite of the fact that 87 percent of its trade with the U.S. was already free. A similar time frame would situate the final negotiations between the U.S. and Mexico in the middle of the 1992 election campaigns. Combined with the likelihood of greater resistance in the U.S. to an agreement with Mexico, this suggests that the schedule of negotiations has to be carefully considered, especially if Mexico is looking for immediate gains. Mexico wants the process to have a positive impact on the expectations of potential investors as soon as possible, and is aware that if the process goes too slowly, it might have the opposite effect. Thus, preparing a realistic schedule should be a central concern of the government when discussions begin in December.

In spite of these difficulties, there was general consensus that the trend towards integration in North America is growing and likely to continue. In view of this, the importance of ensuring that the potential for positive relations with Japan and the rest of the world is protected and maximized was underscored by several participants. One of the explanations for opposition to the Canada-U.S. Free Trade Agreement in Canada referred to the fear that a continental approach to free trade was less desirable than a global one. On the one hand, Canadians were afraid of U.S. domination. On the other, the restructuring of the world into powerful trading blocs was perceived as a potential threat to global peace and stability.

With regard to the first concern, a tripartite agreement between Canada, the U.S. and Mexico has some potential for lessening U.S. dominance and is thus of interest to Canadians. As for the second concern, it is crucial that an integrated North America be regarded as less than an ideal solution to the economic problems of each member country and that the region remain open to Japan and other countries. This attitude was widely endorsed. It was hoped by several participants that the U.S. would act to harmonize its two track strategy of operating through GATT to promote multilateral cooperation and pursuing bilateral agreements with countries in North America and Asia-Pacific.

But will the creation of an integrated economy in North America, even one that remains open to the rest of the world, really solve the problems each of the three countries now faces? Mexico and Canada are both seeking insurance against rising U.S. protectionism. Further, both countries hope this will make them attractive to foreign investors. And the interest of Japan in both countries is related to the promise of secure access to the U.S. market. Moreover, in the case of Mexico, a free trade agreement with the U.S. would commit Mexican economic policy to a direction that might reassure investors concerned about the possibility of sudden policy changes.

It is likely that a series of free trade agreements would have some impact on investors' expectations, but the benefits might be rather small. A real fear is that due to over-consumption and under-investment, the U.S. market could fail. In recent years, the real living conditions of 50 percent of Americans have declined by 30 percent, a reality masked by the spectacular performance of some sectors of the U.S. economy. The U.S. is not acting to redress this situation. Given the economic problems facing Canada and Mexico, the outcome of integration could be a convergence downwards. Thus, it may well be that the benefits of a tripartite trade agreement depend primarily on what the U.S. does in the near future to improve its savings rate and curtail consumption. The extent to which a regional agreement might help the U.S. improve its savings rate is unclear, but remains a possibility that should not be ignored.

Finally, several participants suggested areas that require further study and discussion. One regards the manner in which a tripartite agreement will address the vast differences in culture and productivity between the three countries. In particular, is North America raising the kind of labor force that will succeed as regional integration matures, and that will allow North America do be competitive globally? A regional strategy for preparing a competitive labor force might be worth considering, and could have the additional benefit of breaking down cultural barriers that fuel prejudices and obstruct cooperation within North America.

A second area worth exploring relates to the lessons that might be learned by considering the continental and global applications of the political arrangements Canada has developed, and is currently attempting to modify, to deal with cultural, economic and geographical differences.

Finally, the extent to which other countries, especially Japan, are beginning to regard North America as a single market would be interesting to evaluate. There is evidence that a number of large multinational manufacturers are acting on this premise, and a sense of the extent to which this impression is spreading and being acted upon may be useful in terms of defining North America as an economic region.

Section III

Japan and North America as Partners in the Pacific Community

Rod Dobell and K. Lorne Brownsey

Introduction

This paper provides a broad-brush sketch of certain aspects of the Pacific region and the emergence of the concept of a Pacific community, and proposes several provocative ideas to stimulate discussion of the consequences of a "Japan-North America partnership" in such a community. Other papers included in this volume address, in some detail, various aspects of regional economic performance and trade relations; this paper focuses on the developing structures for economic cooperation in the Pacific. In doing so, we emphasize three points:

i) There is emerging a world of three major trading blocs, but this *need* not be a bad thing. In a world of "open" regionalism, regional initiatives can promote the liberal multilateral trading and economic system.

ii) Within this overall system, the Pacific region has emerged as a major economic force, and in that region there is emerging a distinct concept of economic cooperation which we argue is particularly appropriate to our times.

iii) The major challenge to be faced in economic cooperation in the Pacific—as well as in the rest of the world—is that of environmental degradation. Management of the global commons is a task to be addressed urgently.

The Global Context for a Pacific Community

Before turning to developments in the Pacific region, a few general observations about the changing structures of economic activity and world trade are in order.

It has become a cliché to note that we have seen the *end of hegemony* in the world trading system. We now live in a multipolar world and a particularly unstable and unsettled one at that. It is no longer the case that one can rely upon a single powerful policing agent for the world economy. There are now a number of key players, all of whom exercise significant political and economic influence. And there are many players in a position to exercise some influence from time to time. The recent Houston Summit meeting has underlined the extent to which Japan and Germany are now ready to translate their growing economic power into political influence.

Secondly, we are also witnessing the decreasing relevance of national frontiers; trade across boundaries is being replaced by the emergence of a *borderless economy*. The phenomenon of *globalization* is resulting in changing economic structures internationally. The relative importance of trade in goods is counterbalanced by significant increases in trade in services, international investment flows, flows of people for business and immigration purposes, transfers of technology and transmission of knowledge. In short, greater economic interpenetration is the most striking feature of current international relationships. It is worth noting, however, that this process of economic integration is driven by corporate decisions, not political calculations. And these corporate decisions are driven, in turn, by changing computer/communications technologies which make possible both an unprecedented degree of centralization in global operations, and an unprecedented degree of intermediation in the exchange of services, many of which can be organized in service enterprises that rival small countries in scale.

Trade policy can no longer deal solely with tariffs and border measures and must extend to include regulatory harmonization and policy coordination between nations. At the same time, it should be recognized that regulatory and social policies driven by trade obligations or notions of "fairness" and "level playing fields" in international economic relations may strike at the heart of domestic political structures and interest group agendas, posing difficult tradeoffs between international commitments and domestic social values.

Thirdly, in apparent lockstep with the forces of economic integration are those of *democratization*, nationalism or political *fragmentation*. Along with economic integration come feelings of disempowerment and disillusionment, giving rise to appeals to ties of ethnicity, culture, and community for economic security. One sees nationalism emerging dramatically in many regions of the world, not just in Eastern Europe, although certainly most prominently there at the moment.

The fourth development we should note is the process of *atomization* or the *twilight of hierarchical structures*. We are currently witnessing the emergence—again partly in response to changing technologies and growing capabilities in the retrieval and exchange of information—of a much more flexible set of relationships and coalitions among smaller economic enterprises that span national boundaries and whose shifting alliances challenge the multinationals for influence in the world economy. Though centralized in ownership, some MNEs themselves become in some ways simply large clearinghouses for bidding amongst corporate divisions for operating mandates.

And finally, we have a growing *environmental crisis* that threatens future development in all regions and in rich and poor countries alike.

These then are some of the underlying forces shaping or propelling us towards new arrangements to promote trade and other forms of economic cooperation.

The Emergence of Three Blocs

Many of the initiatives undertaken in response to these forces are *regional* in nature. In particular, Europe is on the move, changing from the paralysis of Eurosclerosis to a new dynamism in quite stunning ways. This could be good for all of us. European integration has great potential to create rather than divert trade, particularly as linkages are developed between the European Community and the EFTA states (the Nordic countries, Switzerland and Austria) and ultimately Central and Eastern Europe. Within this large and powerful economic grouping, a newly-unified Germany will be the center.

In North America, the United States, still the largest single economic entity in the world, is the undisputed dominant power. Although formal integration is not occurring at quite the pace witnessed in Europe, President Bush has recently declared that "We look forward to the day when... all [countries in the Americas] are equal partners in a free-trade zone stretching from the port of Anchorage to Tierra del Fuego."[1] Bolstered by the 1988 Canada-U.S. Free Trade Agreement and the possibility of the Mexico-U.S. free trade agreement currently under discussion (with Canada expressing its desire to join Mexico and the U.S. in these talks), the notion of a North American free trade zone may come to pass in the not-so-distant future. (Despite Mr. Bush's comments, North America's relations with Latin America remain relatively underdeveloped and a free trade zone of the Americas would appear to be on a substantially more remote horizon.)

Several points are worth noting with regard to a North American or, for that matter, an Americas free trade zone. The first deals with attitudes or perceptions. When viewing North America from across the Pacific, it may be hard to distinguish Canada, and probably Mexico as well, from the United States. The dominance of the U.S. in trans-Pacific economic relations means that for many Japanese, or other Asians, North America and the U.S. are simply synonyms—two ways of describing the same economy. Canada is all too frequently viewed as little more than an American appendage or adjunct. Even when there is a recognition of differences between Canada and the United States, perceptions of the two countries may differ quite significantly from the reality. For example, in a recent survey of 500 Japanese companies, over 30 percent of respondents felt that labor/management relations were better in Canada than in the United States and only three percent held the view that the reverse was true. The same poll also revealed that a significantly greater number of respondents perceived the availability of raw materials to be greater in the United States than in Canada.[2]

These rather surprising results illustrate the need for much further exploration—and perhaps development—of the knowledge base that underpins trans-Pacific economic relations.

This is, of course, a two-way problem—Canadian understanding of Japanese society also leaves much to be desired. The need to deal aggressively with the vacuum in public knowledge and understanding is underscored vividly by the growing credibility apparently being achieved by the revisionist "Gang of Four" American writers.[3]

Given the economic and political importance of the U.S., it is understandable that Canada and Mexico will not attract the same attention as their powerful neighbor. However, as sovereign nations anxious to attract investment and deepen economic links with Japan and other Asian countries, both must make efforts to develop a profile that is more clearly recognizable from that of the United States. It must also be recognized that strengthening North America's trade with Asian countries in the Pacific rim will depend fundamentally on the development of long-term relations with our partners in the region, and on a greater degree of mutual understanding and familiarity with our Pacific neighbors. Such relationships can only result from a sustained and consistent effort to build the social, intellectual, political, economic, transportation and communications links on which success in the Pacific trading environment depends.

These "people to people" relationships are all the more important as trade diversifies away from resources and commodities to include a far greater component of processed goods and especially services. Such "higher value added" trade requires greater familiarity with the different requirements and practices of particular markets and the development of a greater degree of mutual confidence and understanding between buyer and seller, as well as a greater understanding of cultural differences more generally.

It is worth noting that with the continuing integration of the North American economy, as well as the more remote possibility of a free trade zone spanning the entire Western hemisphere, a trade bloc of debtor nations will be more clearly recognized. The EC is buoyed by German surpluses and the Asia-Pacific zone by the surpluses of Japan and some of the NIEs, but no such surplus exists in the Americas. Neither can one be confident that one is in prospect in the near term, despite the remarkable adaptability and resilience of the U.S. economy in the past (not to mention the lunacy—and fundamental immorality—of the spectacle of the U.S. and Canada continuing to draw on the resources and savings of the rest of the world to finance their own persistent consumption binge). This debtor/creditor syndrome has motivated much of the recent U.S. protectionist trade sentiment including the Section 301 Unfair Trade Laws as well as the U.S.-Japan Structural Impediments Initiative. The potential that a regional trading bloc of debtors, led by the United States, could move further in this direction is worrisome to say the least.

About Asia, more will be said below, but for purposes of completing this initial sketch of trading blocs and regional initiatives, one should simply note that a Japan-centered production network with massive Japanese investment and overseas production facilities around the Asian rim of the Pacific has definitely emerged.

So we have a picture of a new, interdependent, interpenetrated economic world with three major regional groupings, centered respectively on Germany, the U.S., and Japan. And, as noted earlier, economic relations among them increasingly involve movements of people, service and investment flows, technology transfers and information exchange—all manner of interactions to which frontiers and borders—and border measures like tariffs—are increasingly irrelevant.

One should not overlook the Orwellian possibilities in all this, or underestimate the potential for conflict as economic interpenetration increasingly overrides old ideas of domestic sovereignty. But neither should we assume inevitable confrontation amongst these blocs. So long as these regional groupings maintain an open posture, promoting intraregional relationships without erecting external barriers, they can be consistent with—and, indeed, lead—the successful development of the liberal world trading environment which must be sought in the closing months of the Uruguay Round and beyond.

It does have to be emphasized, however, that the stakes here are potentially very high. If regional blocs do adopt protectionist stands—and given the proliferation of non-tariff barriers and managed trade regimes this is certainly not a far-fetched scenario—economic growth worldwide will suffer. A recent study for the Asia Pacific Chambers of Commerce examined the global cost of liberal versus protectionist trade policy. The results of this study, presented in Figure III, show just how dramatic a brake on the world economy protectionist policies might prove to be.

What this study shows us is that within each region, as well as between regions, governments must cooperate to work to establish a framework within which enterprises compete without protection. If this is accomplished, regionalism will be a constructive, trade generating initiative and not to be feared.

Figure III. Trade Policy Payoff Matrix*
(changes in GDP in 1988 U.S.$billion)

	North America no change	North America protects	North America liberalizes
EC no change		EC - 80 Asia-Pac - 2 N. Amer - 24 WORLD - 106	EC 94 Asia-Pac 54 N. Amer 93 WORLD 241
EC protects	EC - 52 Asia-Pac - 16 N. Amer - 40 WORLD - 108	EC - 132 Asia-Pac - 18 N. Amer - 40 WORLD - 214	EC 42 Asia-Pac 38 N. Amer 53 WORLD 133
EC liberalizes	EC 117 Asia-Pac 9 N. Amer 31 WORLD 156	EC 37 Asia-Pac 7 N. Amer 7 WORLD 50	EC 211 Asia-Pac 63 N. Amer 124 WORLD 397

Source: Andrew Stoeckel, David Pearce and Gary Banks, *Western Trade Blocs: Game, Set Or Match For Asia-Pacific and the World Economy?* (Canberra: Centre for International Economics, 1990), p.69.

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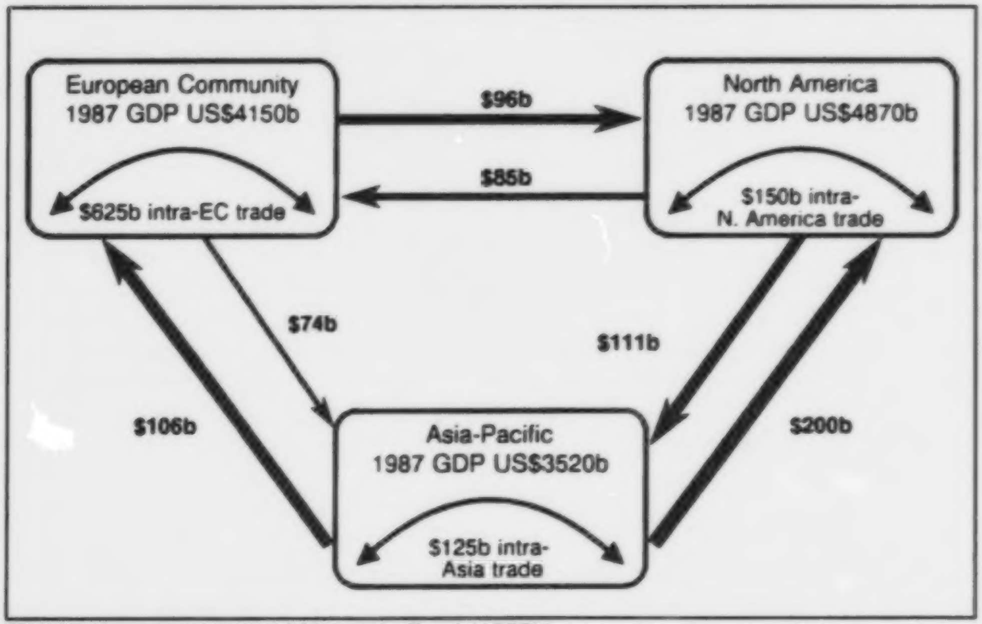
* This table is set out here simply to underline two well-known messages: that the stakes involved in trade arrangements are indeed high, and that, for either North America or the European Community, the payoff to a unilateral move toward a more liberal trading regime is high for all concerned even if it is not matched by other trading partners. For details as to the assumptions underlying this analysis and computation, see the source document cited.

Pacific Economic Performance

We are told endlessly that the "Pacific Century" is upon us and that this region will be the driving force behind the future growth of the world economy. The remarkable economic and trade performances of Japan and the newly industrialized economies (NIEs) of East Asia buttress such claims. Numerous forecasts suggest that by the year 2000 the Asia-Pacific region will account for over 60 percent of the world's population, 50 percent of global production of goods and services and 40 percent of consumption. Figure IV shows that trans-Pacific trade already greatly exceeds trans-Atlantic trade and by the turn of the century it is expected to exceed $1 trillion.

Figure IV. Trilateral Trade Flows in 1988 (US Dollars)



Data source: International Monetary Fund (1989b)
(cited in Stoeckel, *et al.*)

In the case of North American trade with Japan and the Asia-Pacific region, it is important to note that different regions in North America are integrated with the Pacific economy in varying degrees. For example, in 1989, the Asia-Pacific region (or the Western Pacific) accounted for 14 percent of Canadian imports and 12 percent of its exports. However, for British Columbia, Canada's most western province, the Asia-Pacific region was the source of 46 percent of its imports and the destination for 43 percent of its exports. (Presumably a similar story can be told with regard to the Western United States. The importance of ethnic ties and personal networks as facilitators of trade should also be noted.) The implication of regionally diverse trade patterns for national trade policy is significant. With different regions focusing on different trading partners a national strategy becomes exceedingly difficult. Initiatives or policies that are helpful for one region may be a hindrance for another.

The meteoric economic performance of the Asian component of the Pacific rim has been led by Japan, which is now the second largest national economy (and principal lender) in the world. In the 1950s Japan accounted for only about 2 percent of GDP in the industrialized countries. By 1985, Japan's share was 16 percent, and in the OECD Economic Outlook of December 1989, the forecast for 1990 was 20.5 percent of the OECD total. The higher rate of economic growth in Japan, evident in Table V, has altered dramatically Japan's relative position in the world economy.

Table V
Growth of Production in Pacific Economies
Real Gross Domestic Product
Average Annual Growth Rate (percent)

Countries	1965-80	1980-87	1988[2]	1989[2]	1990[2,6]	1991[6]
Developed Countries						
Australia[1]	4.2	3.2	3.7	4.9	0.8	3.2
Canada	5.0	2.9	5.0	2.9	1.9	1.4
Japan[1]	6.3	3.8	5.7	5.1	4.3	3.1
New Zealand[1]	2.5	2.9	0.6	1.4	2.9	1.8
United States[1]	2.7	3.1	4.4	3.0	2.5	2.8
Asian NIEs						
Hong Kong	8.6	5.8	7.4	2.5	3.0	5.5
Korea Rep.[1]	9.5	8.6	12.2	6.7	7.0	7.0
Taiwan[3]	8.5[4]	6.3[5]	7.8	7.2	6.9	7.3
ASEAN Countries						
Indonesia[1]	8.0	3.6	5.5	5.9	6.4	5.6
Malaysia[1]	7.4	4.5	8.7	8.5	8.1	7.5
Philippines[1]	5.9	-0.5	6.8	5.5	5.5	6.1
Singapore[1]	10.1	5.4	11.0	9.2	8.1	6.6
Thailand[1]	7.2	5.6	11.0	11.0	9.1	8.4
PRC	6.4	10.4	4.2	3.9	5.4	5.9

[1] GDP and its components are at purchaser values.

[2] Real GDP/GNP.

[3] Source: White Paper on International Trade, Japan 1988, Japan External Trade Organization.

[4] 1964-1979

[5] 1980-1985.

[6] Estimates from the 1990-1991 Forecast of Real Economic Growth of Fourteen PECC Economies (Table 1 in the Pacific Economic Outlook: 1990-1991).

Sources: World Development Bank, Annual Report 1989.
Pacific Economic Outlook: 1989-1990/1990-91.

High rates of economic growth among the group of newly industrialized economies in Asia have also altered relative competitive positions in international trade. Hong Kong and Singapore have enjoyed robust economic growth based on an outward-looking trade strategy. In conjunction with domestic policies that have shifted from an emphasis on import substitution toward a policy of export orientation, countries such as South Korea and Taiwan have become powerful competitors in the basic heavy manufacturing industries. As Table V indicates, each of these Asian NIEs has enjoyed higher rates of economic growth than Japan. The NIEs are a diverse group, with differences in their domestic policies, in their social and economic structures, and in their external trade and payments regimes, but several of them have emerged as significant international competitors in industries such as automotive production, steel, and shipbuilding, which were traditionally the preserve of the industrialized countries.

A third group of Asian countries in the region can be characterized as those developing economies with large populations that are shifting from a heavy agricultural orientation toward more industrial production and trade. Economies such as Thailand, the Philippines, Malaysia, and even India and the People's Republic of China are following the path trod by Hong Kong and Taiwan, by pursuing more outward-looking policies and expanding their production and exports in labor-intensive, light manufacturing and products. These so-called DAIEs (developing agro-industrial economies) must be expected to exercise significantly increased influence in the coming decade.

An Emerging Pacific Community

Set within this context of dynamic economic performance, economic cooperation, or regionalism, the Pacific is evolving differently from models in the rest of the world, or indeed from the earlier visions expressed for the Pacific.

Two main alternatives have been suggested with regard to institutional development in the Pacific. The first might be described as a comprehensive institutional approach leading to full regional economic integration. The idea of a Pacific free trade agreement was first raised by Professor Kiyoshi Kojima of Japan in the late 1960s and has resurfaced in various forms in subsequent years. The Pacific is, of course, already home to three subregional trading agreements—the Canada-U.S. Free Trade Agreement, the Australia-New Zealand Closer Economic Relations Trade Agreement, and the Association of South East Asian Nations (ASEAN)—and there has been considerable discussion around the notion of broadening these agreements to include other trading partners. However, the jump from subregional to regional integration faces substantial obstacles. Free trade agreements derive much of their strength from the similar heritages and levels of economic development of their member countries. But the Pacific region is notable for its economic and cultural diversity. Furthermore, the ASEAN countries are particularly reticent about such proposals, fearing that their interests might be overwhelmed by those of larger, more developed countries.

A very different view of Pacific regionalism is one that places less emphasis on formal institution-building and more on information flows, consensus-building and negotiating alliances for policy initiatives by a group of countries that wish to take a lead in solving international problems. Institutions might be established to this end, but their role would be more limited, performing particular functions according to the changing needs of the times. This form of regionalism has found its expression in the research and consultation activities of organizations such as the academic Pacific Trade and Development Conference (PAFTAD), the business-oriented Pacific Business Economic Council (PBEC) and the tripartite Pacific Economic Cooperation Conference (PECC) which embraces the other two.

PECC has been particularly effective in bringing together the participation of academics, businesspeople and government officials to review, through its working groups and policy forums, "matters of common concern to the Pacific Basin countries." A Standing Committee, made up of the Chairs of the member committees from each economy represented in PECC, is charged with the task of overseeing conference preparations, coordinating communications between national PECC committees and authorizing the research programs of the PECC task forces, working groups and forums. In recent years the most active of these groups have been the Pacific Trade Policy Forum, the Pacific Economic Outlook working group, and groups dealing with three natural resource based sectors: agriculture, minerals and energy, and fisheries. Recently new PECC groups were formed to examine telecommunications, transportation and tourism as well as science and technology.

In 1988-89 a special working group of the Standing Committee addressed the need for the institutionalization of the PECC process and, more particularly, the establishment of a permanent secretariat. At its November 1989 meeting in Auckland, PECC confirmed that a permanent secretariat would be established in Singapore, and such an office is now operational. Modest in nature, the PECC secretariat is envisioned as a coordinating mechanism to enhance PECC communications, managerial and analytical skills. It does not resemble, nor is it expected in the future to resemble, the large in-house research and analytical organization of the OECD secretariat. Instead, the research inputs for PECC policy positions are, for the most part, generated in a loose network of researchers and research institutions associated with Pacific cooperation. Although the need to maximize the benefits of cooperative research through the exchange of information and a division of labor in specialized work on tasks of common interest argues for a slightly more formalized network of research institutions, supported, for example, by a common electronic communications network, the flexibility provided in an arrangement where institutes can operate both independently and in concert with institutes in other countries allows for regional heterogeneity to be more accurately reflected in the deliberations of PECC.

One of the key issues to be addressed in any discussion of Pacific cooperation is what countries in fact make up the Pacific community. The question of membership in PECC has given that organization some difficulty. Australia, Brunei Darussalam, Canada, China, Chinese Taipei, Indonesia, Japan, Malaysia, New Zealand, the Philippines, Singapore, South Korea, Thailand and the United States now hold full membership in PECC, alongside representatives from the Pacific Island Nations, PBEC and PAFTAD. At the May 1990 PECC Standing Committee meeting in Singapore applications for PECC membership were received from Chile, Colombia, Hong Kong, Mexico, Papua New Guinea and Peru. PECC members' views on new admissions appear to vary significantly. While all countries seemed to support the admission of Hong Kong and Mexico, some appeared to oppose the inclusion of the other Latin American countries at this time. Others also supported the applications of Chile and Peru (Colombia's application was generally viewed as premature) and appeared unwilling to accept any membership package that excluded them. The upshot of this divergence was to defer membership questions to the Standing Committee meeting. Consensus was reached, however, on a set of principles for considering membership applications. Each applying country must:

- endorse the Vancouver Statement[4]
- commit to economic cooperation in the Pacific based on free and open economic exchange
- have extensive economic activities in the region
- establish a viable tripartite member committee
- have made a substantial tripartite contribution to a number of PECC work programs in the previous three years.

By virtue of these criteria, Hong Kong and the Latin American countries just mentioned (with the exception of Colombia) qualify for full PECC membership. This eligibility was recognized by the PECC Standing Committee when it approved their membership in September 1990. With the admittance of Peru, Mexico and Chile to PECC, there will be a substantial shift in the orientation of PECC toward a trans-Pacific character and a likely diminution of the ASEAN-focus. (Indeed, at the same time there is some indication that the ties binding ASEAN itself together are weakening significantly.) This new Latin caucus will certainly infuse into the movement a different perspective on North-South cooperation and may well move PECC to adopt different approaches to structural adjustment issues. Increasing the diversity in an already extremely diverse organization will, to say the least, further challenge its consensual nature.

One must also consider the possibility of a Soviet application for membership in PECC. Although its alleged failure to conform with several of the membership criteria and its dispute with Japan over the Northern territories are likely to block any immediate applications, recent developments would suggest that resolution of both of these problems is not beyond the realm of possibility in the medium term.[5] If PECC does move to admit all of these countries, its cooperative activities will span East-West, North-South and trans-Pacific considerations.

PECC has now been in place for close to a decade and while it has proven an effective tripartite forum for the airing of divergent views, its overall effectiveness in influencing the policy agenda is less clear. The major stumbling block of PECC as a foundation for consensus-building in the Pacific arises from its past inability to develop effective communications with government. Publication and dissemination of reports on PECC activities, and other uses of its Forum and Task Force outputs, have been limited and not very imaginative. Perhaps more important, the National Committees in some member states have achieved only limited success in building bridges with relevant government officials, and especially with political leaders.

However, with the proposal of Prime Minister Hawke of Australia for a Pacific forum of economic ministers, a vehicle for more effective PECC-government linkages, and, more importantly, greater Pacific cooperation and dialogue at an intergovernmental level, has emerged. After considerable diplomatic activity, the first Ministerial meeting of this initiative was held on November 5-7, 1989 in Canberra. It has acquired the name APEC—Asia Pacific Economic Cooperation—and at its first meeting twelve countries were represented. For political reasons, China, Taiwan and Hong Kong, which most PECC members wanted included, were not present (though the prospects for their participation now appear to be improving substantially). The meeting was sufficiently encouraging that four future meetings were scheduled and a slate of priority issues (with a related research program)[6] was established.[7] APEC ministers responsible for trade negotiations agreed to meet in September (in Vancouver) and November (in Brussels) 1990 to discuss trade issues of interest to Pacific countries with the hope of reaching common positions in support of a successful completion of the Uruguay Round of GATT negotiations. PECC sought to provide, through the activities of its ongoing working groups, significant input to these meetings.

Thus PECC is taking some risks—can it be relevant and effective in strengthening the input to an APEC ministerial process? In the context of the rather constrained conditions of the crunch period in a trade negotiation, it is indeed a question how "full and frank" intergovernmental communication will be. Furthermore, should PECC be wary of tying itself too closely to the APEC process? The success of APEC is still by no means assured. Some countries are reported to be lukewarm to the idea of APEC and considerable tension has surfaced on other issues at recent senior officials meetings.

Past and recent developments, particularly with regard to PECC and APEC, point to the distinctly different structures evolving for cooperation in the Pacific. This very loose kind of regionalism has great potential for accommodating the diverse interests in the region and lessening trade tensions and conflict. Indeed, one can argue that this multipartite, non-governmental, consultative forum is precisely the institutional form appropriate for the more pluralistic approach essential in contemporary modes of governance.

However, the benefits of these cooperative arrangements will not be reaped without significant commitment and effort by all stakeholders in the Pacific. Although the diversity of the region creates the preconditions for participatory, consensus-building institutions, it also calls into question the very viability of effective Pacific regionalism. For example, it can be argued that North Americans, or Latin Americans for that matter, have no inherent claim to membership in an Asia-Pacific community. The time is past when Asian countries must come to North America, or more accurately the United States, as petitioners or supplicants seeking a share in the economic output of the world's acknowledged industrial giant and undisputed political leader. The remarkable economic performance of the nations in East and Southeast Asia, led by Japan, suggests that the Pacific community could certainly be defined more narrowly. What this means, of course, is that if the Pacific century is to be more than the Asian century, non-Asians have a great deal of work to do in strengthening long-term relationships with our partners in the region.

Active support of institutions such as PECC and APEC is one way of strengthening trans-Pacific relations. Economic superpowers such as the United States and Japan must, of course, provide much of the leadership and resources in support of these initiatives. But there is also a vital role for middle powers. Canada, for example, enjoys an excellent reputation among the countries in the region because it is perceived as a non-partisan and economically and politically non-threatening player, unlike either Japan or the United States. Accordingly, it can fulfill a vital role as an intermediary or broker between divergent views. Mexico, with its membership in PECC, now part of the Pacific institutionalization process, has the potential to play a similar role, particularly with respect to bridging North-South concerns.

Sustaining the Environment

Sustaining the environment has quickly emerged as the major challenge facing economic cooperation in the Pacific and the world, and one in which the leadership of organizations like PECC and APEC could be crucial. It is becoming increasingly obvious that any lasting benefits from the economic dynamism of the Pacific region depend on humankind's ability to deal successfully with the vast array of environmental problems that have accompanied the unprecedented rates of economic activity much of the world has experienced in recent decades. Simply put, the very scale of human economic activity now poses a devastating threat to the natural environment and human security. We in developed countries must not lose sight of the fact that it is our relentless pursuit of material well-being, financed by an equally relentless drawdown of the earth's natural resource endowments, that is largely responsible for this threat to the global ecosystem. Similarly, we must remember that much, if not most, of the world's population knows quite a different story than ours—hunger, illness, unemployment and illiteracy are but a few of its chapters. The aspirations of these people for a better life depend on unprecedented rates of economic development. The disturbing truth is, however, that based on our current practices of promoting economic growth, development of this magnitude will most assuredly be ruinous. This is clearly a dilemma that requires creative thinking and a fundamental commitment to national, regional and international cooperation. If we fail to achieve clear international agreement on an appropriate "global bargain" to deal with these issues, we face a future scarred by tension and conflict founded in environmental degradation and resource scarcity.

Consider one example. The greenhouse effect is viewed by many as one of the most serious threats we face. Global warming is expected to cause shifting precipitation patterns and rising ocean levels, with catastrophic effects on food-producing regions and low lying countries. How can we avoid this crisis? Part of the answer is straightforward—reduce global carbon dioxide emissions very substantially. Implementing such reductions is, unfortunately, not so simple and would require deep cuts in the world's use of fossil fuels through increased energy efficiency and the development of new non-fossil energy sources.

These changes must be made globally and will carry with them high costs, which will hit hardest in the developing countries which lack the accumulated wealth, technical capacity and infrastructure that more easily enable the rich countries to reduce their energy use. Consequently, solving the greenhouse problem requires international cooperation on two fronts—defining and enforcing an international program of emission reductions, and equitably sharing the resultant costs. A number of proposals have been put forward to promote this type of cooperation, most of which involve raising revenues by measures that discourage fossil fuel use and making expenditures to ease the adjustment burden in developing countries by supporting research and development, technology transfers, and investment directed to sustainable low emissions development.[8] There can be no disputing that such a scheme is fraught with difficulties and implementation problems. But the likeliest objection to the plan—that such large resource transfers from the industrial to the developing world are politically impossible—is simply not tenable. Current energy use trends are not sustainable. The costs of changing course are rightly borne in large measure by those who have benefited most from fossil fuel exploitation. It is also the case that there can be no free riders in such a scheme.

Pacific countries are becoming increasingly involved in initiatives focused on sustaining the environment. Most of the existing PECC task forces and working groups are looking at issues of sustainable development within their mandates and a recent report to the PECC Standing Committee recommends that PECC working groups make a holistic attempt to "assist public policy understanding of how economic growth is compatible with the protection of the natural environment."[9] Intergovernmental cooperation is also occurring on a number of fronts including the APEC working groups on marine conservation, the ASEAN Experts Group on the Environment and regional efforts to control driftnet fishing.

These regional efforts are vitally important, but obviously they must be considered as supplements to, and models for, activity at the international level. Global bargains are imperative if there is to be any hope of reconciling the legitimate aspirations of substantial economic growth in the developing world with the need to sustain and enhance the earth's ecological foundations. The Pacific region has the capacity to provide leadership in the area of sustainable economic development and global bargains. Individual nations in the region have world-leading technologies and expertise related to pollution control, energy conservation and sustainable development. Enthusiasm must be sustained for continued research and development in these fields and for sharing knowledge with developing countries. The combined foreign aid budgets of the countries in the Pacific region (which include the two largest donors in the world) and Japan's immense surplus offer a potentially effective means of facilitating the development of sound environmental policies in the developing countries of the region through debt reduction schemes, technology transfer and other aid/economy/environment linkages.

Conclusion

In this new world of three major economic blocs, "the Pacific" emerges as a political grouping attempting to span two disparate economic regions with profoundly divergent economic performance: a dynamic Japan-centered surplus and creditor Asian region, and a lagging U.S.-centered deficit and debtor American region. The integration of Mexico—and perhaps ultimately all of Latin America—more fully into this American economic region and into "the Pacific" introduces a new Latin presence and Latin caucus into a Pacific community which thus far has been developing some unique approaches to economic growth and adjustment.

These developments pose some institutional questions for discussion. Is it now time for a formal secretariat for APEC, and an "OECD of the Pacific"? Alternatively, given the absolutely crucial significance of the Japan-U.S. relationship (and the need to defuse a potentially explosive popular backlash to the shift in relative economic power and political influence away from the United States) is it time for steps toward a North Pacific free trade area? Given the strength of corporate decisions driving toward global economic integration, and the apprehensions created thereby, is it possible to avoid a politicized, "socialized," managed trade environment? Given the demonstrable economic advantages of even unilateral moves toward liberalization of both the domestic economy and the trade regime in any one of the three big regions, is it possible to avoid protectionist temptations and maintain the posture of "open" regionalism—of "regional means to multilateral ends"?

More fundamentally, recognizing that short-term concerns with effective demand and current imbalances in the payments system are at odds with longer-term concerns with potential supply and real sustainable development, is it possible to find a path toward an adequate flow of savings to meet the development needs not only of the nations within the three emerging regional blocs but of those left outside, and of the massive global bargain necessary to deal effectively with the challenge of global environmental change?

In particular, will it be possible not only to maintain the productivity of the Japanese economic powerhouse—and its trading surplus—but to bring North America back to a point where this region is again making a positive net contribution to the world's resources, weaned away from the perverse phase in which the richest economy of the world finances its own profligate consumption on the backs of the poorer and more thrifty?

We cannot take for granted that the path through the 21st century—the century of the Pacific—will be smooth. The problems are many, the solutions are complex and expensive. Furthermore, a warning sounded a few years ago for the ASEAN countries remains equally relevant for the countries of North America and Japan:

> It is beyond dispute that the contemporary international environment is becoming more hostile: this poses major economic challenges and forces major structural adjustments. While it is fashionable to speak of the 21st century as the century of the Pacific, the possibility that these adjustments will take place in as accommodating a world economy as in the past is remote.[10]

But it does seems clear that a concept of a Pacific community is emerging. What shape that community will take will depend on our ability to successfully forge new and innovative arrangements for cooperation. The roles of Japan and North America will clearly be crucial in that effort.

Notes

1. Quoted in "Bush broadening free-trade horizons," *Globe and Mail*, June 28, 1990, p. B7.
2. Cited in *Canada and Japan in the Nineties*, edited proceedings of a conference sponsored by the Canada-Japan Trade Council in cooperation with the Mining Association of British Columbia and the Business Council of British Columbia, Vancouver, Canada, March 14, 1990.
3. The label applied to writers like Clyde Prestowitz and Chalmers Johnston who argue the case against accepting Japan as a proper pluralist democracy or free market economy.
4. The Vancouver Statement, which was adopted at PECC V, 1986, outlines the principles, structures and activities governing PECC.
5. The outcome of the recent G-7 meeting in Houston underlines the extent to which an increasingly activist Japan may be successful in lining up Western support in favor of the resolution of its territorial dispute with the Soviet Union.

6. APEC working groups are currently being formed to examine issues related to trade and investment data, trade promotion, investment and technology transfer, human resource development, regional energy cooperation and marine conservation.

7. It appears, in fact, that recent meetings of senior officials supporting the APEC process have been sufficiently encouraging that further meetings of APEC ministers have now been planned, for Bangkok in 1992 and North America in 1993.

8. See Dobell and Parson, "A World Atmosphere Fund," *Policy Options*, Vol. 9, No. 10, December 1988.

9. Draft minutes of the PECC Standing Committee Meeting, Singapore, May 4, 1990.

10. Remarks made with respect to the ASEAN, July 1987 - Report of the Group of Fourteen.

Panel Discussion

Adrian Lajous

What struck me most about the paper we have before us is a word that is used frequently: "emerging." Emerging forces, emerging movements. And this leads me to what I want to talk about, which is the difference between the emergence of the North American trade bloc and the emerging Asian bloc. What does the word "emerging" mean in this context?

My position is that you cannot legislate trade into being, you cannot agree to trade when there is no existing commerce. The most you can do in an agreement or in legislation is to facilitate trade. You can take the mule to water but you can't make it drink—that depends on whether the mule wants to drink and whether the water is drinkable. In the case of North America, trade came about naturally, on its own, independently of the wishes of the governments, or even of the people themselves.

I do not know much about the history of the relations between Canada and the United States, but a very distinguished Canadian told me that Canada is a reaction to the United States. It came into being as a reaction to the United States during the revolution and coalesced during the Civil War and the various expansionist attempts of the United States. To many, Canada's obsession with the United States has been: "keep your cotton-picking fingers away from me!" In spite of that, trade took place. We have been told that by the time the Free Trade Agreement was reached, 87 percent of the trade between Canada and the United States was free. So this is something that took place in spite of the fears of many Canadians, in spite of their resistance.

The same thing happened in Mexico. We had a president, Porfirio Diaz, who became dictator in 1876, and lasted for about 35 years. He was very close to the United States in the beginning. He played footsie with our neighbors, he wanted their support, but soon he became wary because this relationship began to overwhelm us. He started to get scared, and about a hundred years ago he made it a point to diversify investment and trade. He preferred no more loans, no more trade with the United States. He wanted more from Europe. But he was not very successful. American penetration in Mexico kept growing during the rest of his regime which ended in 1910. After the Diaz era we had a long revolutionary period where there was practically no trade and no investment. But immediately after the First World War, trade with the United States became the most important element of our international commerce. It continues to be so today.

I joined the Bank of Foreign Trade of Mexico for the first time in 1952, and that is where I learned about Mexican foreign trade policy. The name of the game was diversification. We did not want to depend so much on U.S. trade. We wanted to do more business with Europe and Japan. (Japan was a very important purchaser of Mexican cotton during that period, but I will go into that later, when I speak of relations with the Pacific.) At that time, about 62 or 63 percent of our trade was with the United States. Years later, sometime around 1980, the

Foreign Minister of Mexico, Jorge Castaneda, father of Jorge Jr. who is with us today, made a speech to explain why Mexico was setting a limit on the percentage of oil that could be exported to the United States. Not more than 50 percent of our petroleum could go to any one country, and not more than 30 percent of the needs of any one country would be supplied by Mexico. In this speech he said, we do not want to become too dependent on the United States, because that would be dangerous. But it would be even more dangerous, he said, for the United States to become dependent on us. He did not say so but it was implied that they might want to "protect" their source.

We continued with that policy toward trade and investment with the United States until just a few weeks ago. Now we have given up the fight—at least some of us have. We decided, if you can't lick'em, join'em. It is useless to continue fighting against the tide. The largest market in the world is right next to us. And let me say that the last time I returned to the Mexican Export-Import Bank was in 1979, and at that time I learned that due to our strong efforts to diversify, trade with the United States was no longer 62 percent of our total trade, it was 70 percent.

This is something that came about naturally, organically. Clark Reynolds called it "silent integration." I call it "organic integration." It took place because it fit our mutual needs, and because we had the agility in Mexico to adapt to the changing needs of the United States. We began exporting minerals and agricultural products and went on to export industrial products. Today petroleum represents about 30 percent of our exports, but our non-petroleum exports, fundamentally in manufactured goods, have grown tremendously, and the technological level of our exports has grown very respectably. We have learned to produce higher-quality products and more finished products. We have been able to adapt to market needs across the border.

For example, just last night Francisco Garza was telling me that a few years ago he went to Germany to sell glass-making machinery to a German firm and was turned down. But he was invited by the Chief Executive Officer to dinner and, after a couple of drinks, the man said, "I'll tell you the reason I invited you to dinner. I wanted to see the face of a Mexican who had the nerve, the effrontery to try to sell machinery and technology to Germany." Well, Francisco did not manage to make that sale, but eventually the man was fired and his successor bought machinery from Garza.

There has been an evolution in the type and quality of trade due to the changing needs of the United States, which was the largest exporter in the world and is now the largest importer in the world. Because we managed to adapt and grow, today we have two-way trade of over 50 billion dollars, roughly equally divided between imports and exports. Right now we have a slight imbalance against us, but in the past we have had a balance of payments in our favor. The important thing is that one-half of that trade consists of Mexican exports of growing sophistication. This is something that happened naturally, organically, and what we are seeking now is merely to recognize it and to regulate it in a positive way that ensures that we can continue to export to the United States.

We have heard horror stories from many exporters. Once they become successful in the U.S. market, the affected sunset industries begin lobbying and all kinds of non-tariff barriers show up—voluntary quotas, sanitary problems and the like. All of the sudden our tomatoes are contaminated with pesticides and with worms and so on. But curiously, if a freeze takes place the customs authorities lift all restrictions. They do not even look at the plants. So what we are trying to do is find ways to eliminate these ad hoc limitations that appear every time we are successful.

I am convinced that there is not going to be any impediment to reaching a free trade agreement with the United States. But I do not know what kind of agreement it will be. It may be one that will be unacceptable to us because it includes exemptions in key areas in which we can compete. We are not really interested in the right to export computer chips to the United States because we do not make them. We want to be able to export from sectors in which we are successful—textiles, metal mechanic products, petrochemicals and so on.

We have arrived at a time at which it makes sense for an agreement to be reached because our trade relationship has been a natural development, independent of the wishes of the governments of both countries. As a matter of fact, in some cases it was against their wishes.

Now turning to the other side of the Pacific, I find the links in the Asian community very weak. There is talk of information crossing borders and institutions being set up to discuss what amount of real trade there is in Asia other than that which goes from Japan to the other countries, or raw materials that are coming into Japan. Is there much more than that? This is the question. So I feel that it is a much less advanced situation than in North America. And this leads me to a skepticism I feel every time I hear the term "Pacific Basin." What is the Pacific Basin? It sounds to me as if somebody looked at the map and said "Oh look, there is a basin here, an ocean and all around it are countries. Why don't we call this the Pacific Basin?" But what is the link between the countries, the real link that will make them a community? So far, there isn't any. There are links between Japan, as one of the principal exporters to the world of merchandise and of money, and the United States, as one of the principal importers of merchandise and of money; between Japan and Canada, which exports grain and lumber to Japan, and imports some Japanese products; and between Japan and Mexico, which has an even smaller trade volume.

In 1955 I was sent to Japan to see if we could get Japan to buy more cotton. At that time, Japan imported half a million bales a year from Mexico. Japan was our principal client for this fiber. I was unsuccessful. Japan was upset because we had an unbalanced trade relation and the balance was in our favor. In recent years, trade has been centered in petroleum. Fortunately we are "depetrolizing" our economy and now we want to export manufactured goods to Japan. That, of course, is what everybody wants, particularly the United States. We have all been singularly unsuccessful.

There is a natural flow, however limited or however large, between Japan and North America. It makes sense for Japan to be taken into account in anything on which we agree between ourselves. We must keep an eye on Japan. We must always be aware of that country. It is an important part of the equation. As for the rest of Asia—well, some countries such as Korea and the little tigers are growing. They are exporting, they are becoming factors in this flow of trade, and it is time to start watching them, too. But I really see no connection between Ecuador and the Philippines, or between Canada and Vietnam. The Pacific Basin is an abstract concept. I do not think it really exists, unless it is a code word for Japan.

This is the major difference in the real integration that is taking place on its own in North America, and the pseudo-integration that it is hoped will take place in Asia. I must admit, in spite of the fact that I claim to be a specialist in everything, I am not a very good specialist in Asia. As a matter of fact, I do not know anything about this area, but these are my views on certain differences, on what merging means, on how you emerge into a merger. I have not gone into, and I don't need to go into, all the problems this engenders outside of the trade field. I will let my colleague Jorge Castenada Jr., if he wishes, explain all the difficulties and all the problems that can arise politically and socially, and that are related to the fear of being absorbed by the monster next door.

There are people who have a machine called a "complicometer," and whenever they do not want to reach an agreement they take the piece of paper that contains the proposition and put it in the complicometer. Out will come all sorts of complications. Jorge Castenada Jr. is very good at that. Jorge is against the trade agreement between Mexico and the United States, so he can tell you all the complications, some of which do exist, and some of which are a product of his complicometer. There are real problems, of course, but Mexico has one strong defense that Canada does not have: we have our own language, our own culture, and our own ancestral fear of the United States. These will let us fight a rearguard action in the process of integration, when it goes beyond trade, as sometimes happens.

Elizabeth D. Sherwood

I would like to touch on some of the institutional issues that Rod Dobell raised in his paper. If we look at the people/power revolutions that have taken place in the last year—and I agree with Adrian Lajous' point that it is the people who move beyond governmental structures, and corporations which make decisions that precede government decisions to follow—we see a world emerging that is no longer bipolar and as a result, a new security agenda that is no longer solely military. It will most likely be economic, if we follow what emerged yesterday to its logical conclusion, and we will look at the "black holes" in our own economies, we will look at holes in the ozone layer, we will have an environmental agenda that will be urgent on a global scale. There will be new arrangements and new alliances that will form to deal with these problems. They will most likely be less formal and rigid than the military alliances that have divided the world for the last forty years.

Alliances such as NATO were successful because of a clear and defined common threat that endured for forty years and kept the allies on track with a common purpose. To be successful in the future, alliances that are focused on dealing with economic problems or environmental issues also will need to have common purposes based on common interests and capabilities that are complementary. In a situation like the one we face regarding the United States and Mexico, one of the issues we really have not adequately addressed is the extent to which a free trade agreement has to deal with tremendous discrepancies in economic capabilities. These discrepancies will have to be reconciled in a complementary fashion for a formal economic alliance between the two nations to work effectively.

Rod Dobell asked the group: What kind of structures will we see in the future? Will we see more PECCs? Based on what has happened in the past forty years, I think the answer is yes, we will see more of them. The United States, Canada and the Western European nations have dealt with many issues that were not on their formal military agenda, but which affected their interests, by creating what has been called a "principal nations group." For example, in 1987 in the Persian Gulf, a case which Ambassador Mizoguchi alluded to last night, the Japanese sent technological assistance to ships trying to clear mines. We had a group of nations in the Gulf responding to a crisis not so much under the NATO umbrella but because they recognized that common interests were threatened and they needed to respond. It worked very well. It was informal, it was ad hoc, it did not threaten any of the egos of the powers involved. For example, the French had been very resistant in principal to any public cooperation with the United States in the Gulf, but when it was done on an ad hoc basis outside of a formal alliance framework it worked very effectively. In the future we will need to look at flexible ad hoc groupings of nations with interests that are shared and with capabilities that are complementary, in order to deal with some of the issues we have been talking about over the last day.

This leads me to the one issue that I feel really has not been adequately addressed, which Ambassador Mizoguchi raised in his speech last night: Where does Japan fit into all of this? As he said, we—that is the U.S. and the poorer Western powers—want Japanese money, but we do not want Japanese influence. We have not dealt with the issue of letting Japan sit at the table. I think in any of these organizations that we are talking about there is going to have to be a place for Japan, and we are going to have to deal with tremendous resistance. A recent edition of the *New York Times* contained the results of a poll which said that 64 percent of the American people say that Japanese investment in the United States is a threat to American economic independence. Yet we are asking the Japanese to pump up our economies and invest in us, so there is something that is not reconciled in terms of the role that Japan is going to play. It cannot be asked to play the role of economic superpower without recognizing that it is going to have political clout as well. Similarly, in a recent issue of *Hemisphile*, Gabriel Szekely asserted that Latin America will not be able to move forward without Japan's help. Again, there is the issue of whether Japan's help will infringe on the sovereignty of the nations that are asking for it.

To summarize some of the competing interests in the equation: We are asking the Japanese to put money into Latin America; the Japanese want to assist with development in the Asian region based on their own well-recognized interests; we have not even mentioned Africa or touched upon the tremendous needs that Africa has for development; and if you get into the question of environmental degradation, no one has addressed the extent to which that is going to be a major threat when development proceeds without any environmental regulation. So I would say that efforts like this one are clearly a good beginning in identifying commonalities among the nations involved, including the Japanese, and in recognizing the possible points of friction that are going to have to be addressed more effectively as we move into this new era in which the nation-state will be less relevant. In this era, there will be many more relationships across borders, non-governmental actors will play a greater part, and governments are going to have to keep up with what has clearly already happened in many areas of the world.

Yoriko Kishimoto

I noticed as I was talking to a number of people here that there was some confusion as to whether I represent Japan or whether I represent the United States. I represent a new breed: I am Californian.

I would like to start by stepping back and asking the question, why are we spending this beautiful weekend here talking about NAMI? I understand that NAMI is a young enough organization that this is the kind of thing you are still talking about. To answer this I have to go back 50 years to the time when war was breaking out in Europe and Asia. We were lucky enough to have been given a second chance, but we know that next time there will not be a second chance. I think the overarching concern of everyone is how to build a growth-oriented world order—an order that will inevitably be characterized by cycles in which nations get weak, nations get strong, economies decline, economies grow, new ideologies and new ideas appear and disappear, things grow and die—without leading to the catastrophic effects of large-scale war.

My answer to how we achieve this is two-fold. First, we need an open system, what Shumpei Kumon was suggesting yesterday when he spoke of system management or system society, in which nations actually learn to listen to one another. For the last forty years it has been a one-way flow. Everybody listens to the U.S., but the U.S. still has not learned to listen, and I suspect it is going to take another ten to twenty years for the U.S. to truly learn to listen to other countries; hopefully we will survive those next twenty years.

Second, we need a common vision, a new common goal for the world. As you know, in the last year or two there has been a dramatic trend in a lot of countries toward adopting democratic and free market principles as the forces that are going to be driving the world. Ironically, just as we get to this stage, Japan is saying that these goals are good but insufficient. A free market will not solve all our problems. It will not solve the problem of the environment that we discussed. It will not solve the problems of less developed countries. We do not have a framework for discussing which less developed countries we should help. Or whether we should we help them at all or simply let them fall through the cracks of the free market; although obviously we cannot afford to do that since we only have one earth.

I was in Tokyo last week and I read some of the Japanese commentaries on the G-7 Summit. I found it interesting that, after all these years of us complaining about Japan not having a philosophy, the complaint of the Japanese was, after listening to the proceedings of the Houston Summit, that the Western world no longer has a philosophy, that the G-7 was kind of a meeting of technicians getting together, rather than builders of the new world. Obviously this kind of discussion has to take place with Japan, and with Latin America, as very active participants. So I guess one question to ask of NAMI is, What are its goals? As has been said before, some people say Canada defines itself as being non-American—are you going to define NAMI as non-Japanese or non-European?

Even if you say you are non-Japanese, an important thing to realize is that Japan is changing dramatically and very rapidly. It is a moving target and it is going to move faster. Kenneth Courtis very eloquently talked about the tremendous, almost unbelievable momentum there is in Japan today. I can testify to that since I work in the high technology area. The excitement and kind of fever in Tokyo today is reminiscent of the United States twenty years ago. They cannot do anything wrong, they are investing at a tremendous rate, innovation has just begun, and the productivity issue that Rod Dobell raised is going to be a tremendous issue. Productivity is growing so fast in some parts of the world that it leaves little margin for error—other countries either have to learn quickly to keep up, or have to learn how to manage the differences.

One change that is taking place in Japan was noted by Ambassador Kikuchi and that concerns Japan's opening markets. I know that there is tremendous skepticism today about Japan's opening markets. All the countries in the world have tried for the last thirty or forty years to break down the barriers to get into Japan. But I believe that Japan is going to open up fairly dramatically. It has started to over the last couple of years. For example, according to some figures I saw, in 1988 manufactured imports by Japan were up 39.2 percent. In 1989 the figure was 16 percent. These are fairly dramatic numbers and I think this trend is going to continue. This is going to be a hole, not a "black hole," but perhaps a "white hole" that will drive the world economy forwards.

A lot of people are also unaware of the changes taking place in Japanese society. Two little things that I heard in Tokyo last week are illustrative of these changes. First, a friend of mine, a Caucasian American, who had just gone over to Japan this year, became the first formal non-Japanese member of the Tokyo University medical faculty. This was the first time a non-Japanese person had been allowed to come in as a national employee, a formal member of the faculty. I found that quite significant. The second thing I heard about, which I thought was even more significant, was that in the popular press, the Japanese are re-exploring their roots, tracing them to the Middle East, to Iran and Afghanistan. This is an important process because, as you know, Japan has traditionally isolated itself from the rest of the world saying, "We are very unique, nobody else is like us, we were born from Amaterasu and nobody can truly understand us." For Japanese to begin to recast their identity and to find their roots in the rest of the world is a very important aspect of Japan becoming part of the world community. I found this very encouraging.

Now to briefly address the issue of regional ties. I must confess I am not an expert in this area, but I can throw out a couple of ideas. One is that I agree with Elizabeth Sherwood that instead of formal alliances, we are going to see a much more informal and very complex network of alliances, and multiple alliances as well. One analogy that I use is to look at how the private sector multinational corporations operate. It is such a dizzying network. Take, for example, IBM's alliances in semiconductors: they have a relationship with Siemens in terms of developing their 64 mb semiconductors; they have a deal with Sematech, which is trying to help the U.S. manufacturing sector recover; and I think they have licensed their technology to Micron Technology. So a big company like IBM does not limit itself to one strategic alliance, it is multiple, complex, and shifting. I suppose it introduces instabilities to some degree, but that may be the type of world that we are moving towards.

Another dimension that really has not been touched upon in this conference is the role of technology. Going back to the multinational corporation analogy, multinational corporations have been able to operate through this very sophisticated global networking because of telecommunications and computers. The public sector needs to catch up. There is definitely a big role for the public sector in global governance, but if the public sector does not catch up technologically, it is not going to be able to keep up with the corporations, and I think we are going to see some chaos.

Another thought I had, which may be far out in left field, is that if economic competition and technological competition are becoming as strategic as military competition, perhaps there is going to be a kind of arms control negotiations for economic and technological progress, such as "you cannot grow more than ten percent this year," or "you cannot develop this technology because it is destabilizing," and so on.

The problem facing the world is that the United States is going through a very painful transition from being hegemonic to being who knows what, and I guess the alternatives for NAMI are that it will either help the transition to the next order, or get in the way. In part, this depends on whether Canada and Mexico can stand up to the U.S., and on whether—because I think as has been raised in some of the discussions that Canada could introduce a new attitude in dealing with Asia—the U.S. has been handicapped because of its past political baggage. Hopefully NAMI will not become a code word for the United States.

David Crane

Our discussions are really about how the world system is going to be managed in the future, including security arrangements, economic performance, human welfare, and the advancement of the interests of nations. The consensus that seems to be emerging is that the world is dividing into blocs and this is an inevitable stage in human development. There will be a German bloc called Europe, a U.S. bloc called North America, and a Japanese bloc of trade and currency called the Asia-Pacific. But this is something that we should examine very closely to see how desirable it really is.

It is possible to visualize these blocs as the new empires, or as comfortable clubs that exclude those parts of the world—the "black holes," as they have been described—that nobody wants to look after, leaving them out there to hang on their own.

From the perspective of a country like Canada, the development of blocs is a matter of concern for a variety of reasons. One is that it raises the question of what the role of the junior members of the blocs will be in the international community. Are we just along for the ride because in effect we will have a G-3 determining policy and the rest of us will more or less have to go along with whatever the G-3 decides?

I think regional cooperation is critical in many respects, and countries and regions should work in a cooperative manner whether it is on the environment—such as an acid rain treaty between Canada and the U.S., or a similar treaty between Mexico and the U.S.—or on ways to increase contact for trade and investment such as tourism, or any other of those relations or shared interests that exist between neighboring countries.

But I think we have to recognize as well, that there is more at stake than this. For example, the post-war world trading system that emerged was informed by a concept of multilateralism and built around the notion of the Most Favored Nation formalized in the General Agreement on Tariffs and Trade. This gives all nations who belong to that system equal access to one another's markets. There are other multilateral institutions, such as the IMF and the World Bank, and I suspect someday we will have something similar to deal with the environment. The underlying principle in all of the institutions that deal with world problems is multilateralism.

It seems to me that a first priority is to concentrate on strengthening these multilateral institutions. While much can be achieved through regional cooperation, there are many risks, especially if the world is organized into formal regional blocs.

Blocs can be divisive, and one can visualize this in the high tech area. We have heard many complaints about the mistakes that have been made by countries in the past while trying to promote "national champions" in industries such as computers, telecommunications, and other areas of new technology. A world of blocs will lead to bloc champions. We are really transferring to a higher level the dispute we have had in the past about national champions. And it is easy to envision other forms of bloc rivalry that can be divisive or worse.

There is a definite trade diversion effect with blocs as well. The Mexico-U.S. bloc being discussed has to have a damaging effect on the NIEs in Asia, jut as it has to have a damaging effect on the clothing producers of Bangladesh if Mexican clothing producers get special access to the U.S. clothing market. In the Canada-U.S. FTA there was a provision designed to restrict the activity of the Japanese automotive industry in Canada and the U.S. There were both intended and unintended trade diversion effects.

Another problem with blocs is that they leave out a lot of countries, notably the poorest countries. Which bloc wants Bangladesh? Which bloc wants Haiti? Which bloc wants any of the countries that have very serious problems? We still have an obligation to deal with this new global community in which we are living, to deal with the problems of these least developed countries. But they do not fit in—I do not hear anybody talking about which bloc Bangladesh is going to belong to. So blocs could be quite damaging to these developing countries which have very significant and difficult needs.

Finally, another problem with blocs is that they reduce the role of small or middle-size countries in the international system. There is less scope for diversity and democracy, and more reliance on power politics and the G-3.

When I look at the world agenda as we move into the twenty-first century, I see many difficult issues and many exciting opportunities. It seems to me that the first priority is to determine what kind of global management system we really want—is it a truly multilateral system or is it a bloc system? I think a multilateral system has much more to offer.

We have had considerable discussion of the relative roles of the United States, Japan and other parts of the world. But in much of the discussion, Europe seems to have fallen off the map, even though it is a very significant part of the international economy. There is no doubt that the power and influence of the U.S. is declining and in one respect that is nothing the U.S. should feel self-conscious about: U.S. postwar policy always intended that the relative position of the U.S. in the world economy would decline. But in another respect there is a concern as to whether the U.S. has a sense of its own direction and is managing its own affairs as well as it could. This is very important because in the final analysis the U.S. remains the custodian of the international system—nobody else is lining up to take over the role of ensuring that the international system functions properly or to address the impact various developments in the world will have on the international system.

It is true that other parts of the world have a bigger role than they had in the past. Europe is taking on more of the responsibility for Eastern Europe and the Soviet Union; Japan has played an almost heroic role, certainly an expensive one, in financial markets with respect to market stability and it gets very little credit in the U.S. Congress or anywhere else for the crucial role it has played there and the costs it has borne by doing this, which have been very high. But for the foreseeable future the U.S. is going to remain the custodian of the overall system, because nobody else wants to do it. Still, we are moving into a world of greater decision-sharing. The U.S. has been much quicker to come out for burden-sharing than for decision-sharing, and it somehow has to bring those two things into line. This will not be an easy process, especially for the U.S. Congress.

A second priority that we have to keep in mind is the need to address North-South issues. These are being pushed off the global agenda. The fact remains that if one accepts demographic trends, we will have 850-900 million people being born in this decade. Almost all of them will live in the developing world, and the disparities appear to be growing between the rich and poor countries. Throughout the 1980s per capita income has steadily declined in sub-Saharan Africa and the standard of living in Africa today is on a par with what it was in the 1960s. On average, per capita income declined in Latin America and the Caribbean as well.

If you look at life expectancy at birth—in African countries it is 44-46 years, while in Japan it is almost 80. This is a tremendous disparity. The infant mortality rate in the Indian subcontinent is 170/1000 live births dead before age five, as opposed to just 5/1000 in Sweden. These are the great challenges that we have to deal with in North-South issues. We have several hundred million children in the world today who do not even go to primary school.

North-South pressures are going to grow more serious and more difficult to deal with, and while regional blocs may be of some help in dealing with these issues, we really have to increase the strength and capacity of the IMF and World Bank, and after that the regional development banks, to deal with these issues.

Again, when we talk about the role of Japan, we must welcome the increased attention that Japan has given in these areas. But while we welcome it, it should also be kept in perspective. Last year, Western world aid declined by two percentage points in real terms. Japan has made a quantum leap in the amount of aid that it gives officially, but it is only up to 0.32 percent of its GDP, and the goal of the Western world has for many years been 0.7 percent. Now we are trying to get up to 0.5 percent, so even though Japan is the largest donor in actual dollars, as a percentage of its GDP it is still relatively low compared to many other countries. And it should also be noted that the U.S. situation is worse, because it is declining. It is now down to 0.15 percent of its GDP, the lowest it has ever been. And much of that aid goes to Egypt and Israel. So we have these important international issues to deal with.

One very last point: some Canadian advice for Mexico's free trade talks with the U.S. There is a tendency on the part of some Mexicans to assume they will be able to confine the negotiations to certain areas. I think Mexicans should recognize that when they start these negotiations everything is on the table. They cannot go into these negotiations saying, "We are not going to talk about banking, we are not going to talk about energy, we are not going to talk about this or that"—the very act of embarking on negotiations means everything is on the table.

It is also important to recognize what a free trade agreement will not accomplish. It is not going to exempt Mexico from U.S. trade law, it is not going to exempt Mexico from future changes in U.S. trade law, if the Canadian case is generalized, and it is not going to protect Mexico from the application of future U.S. non-tariff barriers. Nor is it going to end border paperwork and all of these kinds of things.

Free trade negotiations inevitably raise a wide range of issues from culture to industrial policy to energy arrangements to regional development—an enormous range of concerns. A country going into free trade negotiations has to be extremely well-prepared. If it is not, it will end up with a bad agreement. Especially because once a country has committed itself to free trade negotiations, it feels that it has to conclude an agreement even if it is not happy with the terms, just as Mexico ended up adopting the debt negotiation plan which was less than what it should have settled for.

There should also be some way for the Mexican people to express themselves on what is negotiated. It should not be a sort of rubber-stamp vote where the government party has the majority of seats. There should be some way in which the content of the agreement can be put to the people so that it has some kind of legitimacy, or in case the people decide they do not want it.

Plenary Session Summary

Participants in the third plenary session addressed four distinct issues: the problems associated with creating an integrated North America; the status of a powerful, but capital poor, North American bloc in the international system; the extent to which this process of integration will be responsive to a wide range of contemporary concerns, particularly environmental degradation and the plight of the Third World; and the North American Institute's potential contribution to resolving these issues, and to providing input into the policies that will manage the process of integration.

With regard to the first issue, it is not at all clear that a firm basis for regional integration has been adequately identified. Indeed, one participant suggested that a trade agreement between the U.S. and Mexico might be quite different from the existing Canada-U.S. Free Trade Agreement. The Canada-U.S. agreement was not perceived as threatening to the U.S. This perception may change in the case of Mexico, which has a distinctive culture and an abundant supply of cheap labor. These two potential sources of concern to the American public could problematize negotiations and create pressures to gain clear, short-term gains. In consequence, there is a need to identify the sort of agreement that would be fair to Mexico, especially because it does not have any particularly powerful bargaining chips to bring to the negotiating table. In the long-term, a fair agreement is probably in the interest of the U.S.—but this is a possibility that needs to be further examined, especially in view of the U.S.'s predisposition to act to maximize its short-term interests. One consideration in this regard is that a Mexico-U.S. free trade agreement would likely serve as a model for, or in some way have a profound impact on, subsequent economic initiatives with other developing countries.

If an agreement is reached, a new problem is likely to arise in terms of the next step—bringing all three countries together. This could be a difficult process, and perhaps it would have made greater sense to include Canada in the negotiations from the beginning. However, while Mexico is interested in discussing and learning from Canada's experience in negotiating with the U.S., it is concerned that Canada views Mexico as a competitor whose success in this area might nullify some of the gains it achieved in its agreement with the U.S. Because of this, Mexico fears that Canada might have an interest in complicating or undermining the Mexico-U.S. discussions. But whether Canada is included in the current negotiations or invited to join an agreement later on, the terms that will make regional integration attractive to all three countries still need to be worked out.

It is also possible that the movement towards regional integration will stall. This would have a negative impact on all three countries, but particularly on Mexico and Canada. It is, therefore, important that the process be managed in a way that will be able to resolve the conflicts that will inevitably arise.

In any case, it is clear that North America is changing in dramatic ways, and that these changes at the regional level, even though far from assuming a stable, institutional form, will have a profound impact on the international system. It is, therefore, essential that North

America's relationship to the world beyond its borders be discussed alongside discussions of regional concerns.

One problem likely to continue to confront most of the world is the gap between the supply and demand for investment capital. Demand is certain to increase due to decaying infrastructure, environmental problems and the growing needs of developing countries. For this reason North America needs to continue to focus on its relationship with Japan, which is destined to be a principal source of investment capital for some time. In particular, it will need to convince Japan that North American economic integration will provide good, reliable opportunities for trade and investment. Japan's financial exports are likely to decrease in the future, and it is likely to seek to diversify its direct foreign investment. In order to remain attractive to the Japanese, North America will have to find a way of guaranteeing access to its vast market on terms acceptable to the Japanese.

North America is not the only powerful regional bloc taking shape in the world. A European bloc, centered around Germany, is already well-advanced, and an Asia-Pacific bloc, centered around Japan, is widely perceived as a distinct possibility in the not too distant future. This sort of restructuring of the international system carries with it tremendous potential for prosperity, stability and global problem-solving. But it could also prove to be highly destabilizing and destructive. Given the magnitude of contemporary threats, it is essential that North America have a conception of where it is headed. In developing such a conception, several things need to be considered.

First, what sort of identity will North America develop? Will it tend to identify itself as essentially a European power, playing a role that has been historically defined? Will it view itself as a global entity with global responsibilities? Or will it tend to isolate itself from world affairs and retreat into a continental fortress that will become the principal ground of its identity? Developing such an identity is important because it will facilitate regional integration as well as communicate North America's intentions to the rest of the world. These questions, incidentally, also need to be addressed by the Japanese.

Second, what will the status of the developing countries be in the new world order? Will they be fully integrated into the economic system, or will they remain on its margins? Mexico presents the U.S. and Canada with the opportunity to address this question, and to start working out the basis for mutually beneficial economic relations with the Third World. And Mexico, which has strong cultural affinities with its southern neighbors, has an interest in ensuring that this question is addressed.

Third, what forms of cooperation are and will be desirable in the world? Several participants expressed the belief that North American regional integration would only be desirable insofar as it served as a step towards, or remained compatible with, forms of multilateral cooperation that are essential for dealing with a wide range of global problems, both traditional and unique to the twentieth century. In this regard, the terms of a free trade agreement between Mexico and the U.S., and the terms on which Canada would be included in such an agreement, will have a profound impact on the sort of role North America assumes in the world. In developing these terms, the three countries might benefit from remaining active in and promoting looser, and more global, associations such as PECC, which might also serve as a sort of damage control mechanism should negotiations stall.

Finally, how will the three countries deal with the various domestic problems integration will inevitably cause? How will national identities be protected? How will those who are initially disadvantaged by the changes be assisted? How will things like environmental regulations and social welfare programs be harmonized or protected? Because North America seeks to unify three countries with strong differences in the cultural, economic, political and social spheres, the success of this state-managed integration process requires that these questions be addressed. And in answering them, North America may develop policies and strategies that will be useful for negotiations with or in other parts of the world.

A final concern of the third plenary session was to identify a direction for NAMI. Although this issue is discussed in greater detail in the following section, it is worth briefly noting several suggestions. The rapid pace of the transformation of the international system has created a need among policy-makers for a continuous, objective assessment of the trends that are shaping this transformation, the areas that require immediate attention, and the issues that are not receiving adequate consideration.

Several participants proposed ways in which NAMI might provide important and constructive input into the policy-making process. It was generally agreed that the decision to devote a special session to North America's relationship with Japan had been very successful. In the near future, similar sessions might address North America's relationship with Latin America and with Europe. Another area which requires attention concerns the impact contemporary technology is having beyond the economic sphere, particularly on social issues and environmental issues. In particular, NAMI might explore the social and environmental problems associated with North American economic integration. And finally, within the economic sphere, NAMI might consider the relationship between the political process of integration and the behavior of non-governmental actors, who are, in a sense, at the vanguard of this type of transformation.

Concluding Remarks

Mason Willrich

Jack, you really have done a wonderful job of organizing this meeting, including the weather, which I am sure is always like this in Vancouver. On behalf of all my American friends, U.S. friends, we are all Americans, we thank you for these arrangements.

The task of summing up is one that I approach with a good deal of humility. Let me briefly make several points which are at the top of my mind, having tried hard to be a good listener.

My first point relates to security. We started by noting the shift of emphasis from military-political security arrangements to economic-political security arrangements in the post-Cold War era that we are embarking upon. There is an enormous unfinished agenda in terms of the tremendous military industrial complexes that are in place and that continue to produce in the industrial countries. This is something we must deal with when we talk about arms control, the future of the NATO alliance, the Soviet Union and the kind of world order where economic security can really become our primary concern. A related concern that we did not discuss is the spill-over effect on North-South issues. With this enormous productive capacity in the military industrial complexes and the predilection people have to sell, sell, sell, markets apart from Europe are being developed for military hardware.

Our focus here has been on North America's relationship with Japan and the economic security dimensions of that relationship. We learned that each of the North American countries has a very important bilateral relationship with Japan. The question is, How do we evolve from that set of bilateral relationships, if we do? Should we evolve in the direction of a trilateral relationship with the North American countries, or larger bilateral relationships with Japan? We heard from Japan that they would welcome a quadrilateral relationship. In my opinion the terms that are agreeable to all parties will determine the model. Each of the North American countries, for its own important reasons, wants to work toward a situation in which each remains open to a set of relationships beyond the North American relationship, and each country wants to be enhanced in the future by the kind of arrangement it makes with Japan. At the same time, each wants to be enhanced by the kind of relationships that are built among the North American countries themselves. So it has to be a very positive forward movement. The notion of threat that we focussed on as an organizing principle when the military-political paradigm was salient somehow needs to be dropped from our vocabulary and replaced by something much more positive in terms of thinking through what we mean by economic-political security.

We also looked at perceptions versus reality and how perception becomes part of political reality. We had an excellent discussion about the concern, particularly in the United States, but which spills into other countries, over negative perceptions of Japan. This concern results from the very dynamic and increasingly assertive economy of Japan. All of us have to be good listeners. Our Japanese friends need to listen carefully to the prescriptions of others for responsible roles they must play, and Americans need to learn to listen to prescriptions from the outside about their responsibilities. There is a very important U.S. bilateral relationship with Japan that needs to be worked through in terms of real reciprocity as we both define our respective roles in the new global economy.

Perceptions aside, I think that we are already linked, and that we are very much in a situation where there is true mutual vulnerability within the global economic system. Mutual vulnerability between the U.S. and Japan in our bilateral relationship certainly affects relationships between the U.S., Canada and Mexico. We need to recognize that it is not a zero-sum game but rather a situation of mutual vulnerabilities and potentially mutual benefits.

Now let me say a word about the U.S. as the continuing center of the international system. One major concern is that we have a downward convergence within the North American continent, that has been offset, of course, by the dynamism of a Japan that is surging ahead. I do not think that is the way we should look at this. Rather we need to approach the situation with the common objective of placing the three countries in North America on a path where together we create an upward convergence. In my view, if it goes downward, it does not lead to convergence but rather to disintegration. The only way that the three North American countries are going to converge is on an upward path. The Japanese-U.S. dialogue has become very frank in terms of the Japanese telling the U.S. what we need to hear. We had a very good dose of this on the question of the U.S. savings rate. I would recommend that in terms of the U.S. relationship with Canada, and more particularly in our relationship with Mexico as we approach the free trade negotiations, there be an escalation of the frankness of the dialogue with the understanding that if we are going to be partners we need to have candor. Mexican and Canadian concerns need to be expressed in a way that we can listen to and adjust to and look forward to.

That much said, I am left with a conundrum in terms of the U.S. as the center of the international system. On the one hand, yes we have to get our savings rate up. On the other hand, yes we have to maintain demand within the U.S. economy in order to continue to sustain many other economies in the world. I do not believe that the so-called peace dividend is going to do nearly enough to create a situation where we can have both a dramatic increase in our savings rate and a continuing increase in our consumption. We in the U.S. need to work out mutual relationships in order to get on with the next era in a way that is not going to undermine the potential for growth in the global economy.

Lastly, I would like to mention the question of distributive justice. There are two parts to this question. In our negotiations with Canada, Mexico and Japan, we must address internally within the United States a very important unfinished agenda of distributional equity questions. At the same time, these matters need to be addressed outside of the country in terms of North-South relations.

Jesus Silva-Herzog

I would like to summarize a few points that I think were quite interesting. First, there was a very significant declaration of the formation of regional blocs in different parts of the world. There is not, however, a consensus as to whether this is going to be good, bad or indifferent. Are they going to be open-ended? Are they going to be regional means to obtain multilateral objectives, as someone mentioned this morning? We really do not know yet. Furthermore, these regional blocs are only in the North, and if Mexico concludes a free trade agreement, we will be the first country from the South to do so.

I think that the formation of regional blocs has a very important bearing on what we are talking about—the North American concept. We had a meeting six months ago and the North American concept was quite loose. Now I think it is beginning to get much more substance—stimulated in a very significant manner by the Mexican decision to initiate conversations with the U.S. toward a free trade agreement. So in my opinion the North American concept is much more clear today than it was six months ago.

Concerning the Mexican-U.S. free trade negotiations, I think there is a lot that we in Mexico could gain from such an agreement—security, access to markets, and so on. But I think an important fact became apparent during this meeting—that is, that everything must be on the bargaining table. I consider it very important that a closer relationship between Canada and Mexico develop during these negotiations. Mexico can learn a lot from the Canadian experience in negotiating a Canada-U.S. Free Trade Agreement.

My second point deals with Japan, which was the topic of this meeting. I was very impressed by what Kenneth Courtis told us yesterday. Everyone, I think, had an intuition that something was happening with regard to Japan and North America, but he told us that Japan is in North America in a big way and it is here to stay. Any relationship within North America will have to take into consideration Japan's role. That is true today and it will be true tomorrow. Now here I would like to point out that the concept of North America, and its relations with Japan, is acquiring a significant meaning. If Mexico concludes a free trade agreement with the U.S., any other negotiations with Japan such as those dealing with investment, trade or technology, will have to be referred, not to a bilateral concept, but to a regional concept. The same will also be true from the point of view of Japan. When Japan is looking to do something in Mexico, it will have to consider, if these negotiations are concluded, its transactions in a regional context.

On the other hand, we must recognize that major decisions will be made between the U.S. and Japan, and both Canada and Mexico are going to have to react to them. And when I say react, I really mean defend, or take advantage of opportunities that arise. A good portion of these decisions will be beyond our influence. This is horrible to recognize, but I think it is true.

Finally, I think we have largely left out Latin America from our discussions. Latin America is very important for Mexico. Mexico is perceived to be closer to the United States than to Latin America. And with a free trade agreement this will be even more so. But I think it is very important for Mexico to maintain a close or closer relationship with Latin America. And also, of course, Europe was quite absent from our conversations, but perhaps this could be the topic of another meeting of NAMI.

I would also like to join Mason Willrich in thanking Jack Austin and his wife and all of the Canadian team who have made this meeting a wonderful one.

Jack Austin

First, I want to thank those of you who made suggestions to NAMI about our future program and the way in which we ought to operate. These are valuable suggestions and they are appreciated.

There is one other subject I would like to bring to our discussion. What we are seeing in the world, to add to our paradoxes, and paradoxes are always the most delightful things to play with, is the globalization of business, certainly in the context of our communities; and, at the same time, and I speak now as a politician, the need, indeed the demand on the political constituency, to restrain that globalization for national reasons of advantage. So you try to go past that issue very quickly and find some way of equitably institutionalizing the globalization processes. And there we come back, it seems to me, to the purpose of NAMI—to help identify the kinds of institutions that can begin to develop the equitable apportionments that are required if we are to achieve, in due time, some kind of world order.

It is my own conviction that it is much more difficult for nation-states to change their culture than it is for individuals. We have had discussions on that subject in the last two days. I can tell you, that we in Canada have an equivalent to the Mexican appreciation of being so close to America and so far from God. As one of our politicians said: "America is our best friend, whether we like it or not." But Mexico and Canada have long complained that the United States is, at best, disinterested.

NAMI's purpose is to reduce these historical anachronisms. So NAMI has a mission and we are searching to define it. We began two years ago as a forum to discover whether there was sufficient commonality among our interests to begin to create some process together, and I think the meetings we have had up until now have shown that there is. Now where do we go? As a result of the representations we have had today and the very critical path which has been outlined, the Executive has decided to hold a meeting in December on the prospects for a North American free trade agreement. Beyond that there is an infinite choice of issues affecting the management of the North American continent. We have just reached a cornucopia of opportunity and our resources are quite finite. They will have to be expanded and rapidly.

I thank you all for the superb conference we have had.

Appendix A

The North American Institute

With the Cold War over, rapid changes in the international system are linking rich nations and poor nations in a new global agenda. To promote growth with equity and liberty but without damaging the environment—the heart of this new agenda—requires a multilateral approach, based on interdependence and cooperation among nations of unequal wealth and power, and different political cultures.

Responding more effectively to global problems points up the need for new configurations among nation-states. Among them, regional groupings seem well positioned to manage large parts of this agenda, and one such cluster is the continent of North America. Thus a new regionalism is emerging, propelled by market forces, enmeshed in the new global agenda, and exemplified by the European Economic Community; by Japan and the Asian Pacific Rim nations; and by Canada, the United States and Mexico.

In North America, our three nations share a continental space that increasingly requires trinational attention to convergent interests and concerns. These include flows of capital and labor within the region, growing intra-regional trade, shared consumer tastes and marketing, faltering systems of public education, and a common concern for cleaning up pollution and for linking energy and the environment. In sum, the need to manage the growing interdependence among our three quite different nation-states is creating a new and quite different policy environment.

The North American Institute (NAMI) is a non-profit public affairs organization founded in Santa Fe, New Mexico by Susan Herter, formerly Chief of Staff to Vice President Rockefeller, and by John D. Wirth, Professor of History and Vice Provost at Stanford University. The purpose of NAMI is to create the first trinational forum in which the concept and realities of North American regional interdependence will be discussed on a continuing and sustained basis among leaders in business, the press, universities and the professions.

NAMI is organized and funded trinationally, and coordinated through the Santa Fe office which has its own resident director. Our aim is to explore, discuss and promote policy-relevant initiatives through the interaction of the three national delegations. Our activities include networking and exchange among the core group as well as issue-specific research, conferences and publications, and advocacy in ways the participants deem appropriate.

NAMI's fourth conference was held in Vancouver, B.C. in July 1990 to discuss "Japan's Relations with North America: The New Pacific Interface." This followed a series of successful meetings in which we developed NAMI's trinational approach.

Our first two exploratory meetings were in Santa Fe, co-convened by the Hon. Maurice Strong and Senator Jack Austin of Canada, Governor Bruce Babbitt of the United States, and former Finance Minister Jesus Silva-Herzog of Mexico. Participants reviewed the history of interdependence among their three countries, discussed their differing national views on specific North American issues, and developed a good working relationship in two off-the-record meetings.

The third conference was held near Mexico City in December, 1989 on the theme "Developing a Sustainable Energy Policy for North America." This conference produced a policy statement which NAMI then submitted to Secretary of Energy Watkins, the first of what we expect will be a series of well-targeted advocacy positions on North American issues.

This is a time of broad and hopeful openings in the affairs of nations. The emergence of North America is high on the list of significant changes in the world system, and NAMI is well-positioned to both follow and influence the course of events.

Susan Herter, President

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Appendix B

The Institute for Research on Public Policy

A National Presence

Founded in 1972, the Institute for Research on Public Policy is an independent, national, non-profit organization with offices across Canada.

The mission of the Institute is to improve public policy in Canada by promoting and contributing to a policy process that is more broadly based, informed and effective.

In pursuit of this mission, the Institute:

- identifies significant public policy questions that will confront Canada in the longer term future, and undertakes independent research into those questions;
- promotes wide dissemination of key results from its own and other research activities;
- encourages non-partisan discussion and criticism of public policy issues in a manner which elicits broad participation from all sectors and regions of Canadian society, and links research with processes of social learning and policy formation.

Governance of the Institute

The Institute is governed by a Board of Directors, advised by representatives of federal, provincial and territorial governments and of other national research organizations, and by panels of external authorities, drawn into *ad hoc* advisory committees formed to assist the

Research Committee. Implementation and administration of the Institute's policies and programs and management of the staff are the responsibility of the president, who is the chief executive officer.

Method of Operation

The Institute is decentralized, employing researchers across Canada. This ensures that research undertaken by the Institute involves contributions from all regions. The Institute also works with individual researchers or institutes in other countries.

Researchers are hired on contract for a limited period, often the duration of a project. This enables the Institute to renew its staff regularly, to reflect the evolving nature of its research program. It also helps to increase the number of first-class researchers employed by the Institute.

Independence and Neutrality

The Institute's independence is assured by an endowment fund, to which federal and provincial governments and the private sector have contributed. The Institute receives grants and contracts from governments, corporations and foundations, both to support program activity and to carry out specific research projects.

The Institute promotes public understanding and discussion of issues of national importance, whether controversial or not. It publishes its research findings with clarity and impartiality. It does not control or influence the conduct of particular research or the conclusions: conclusions or recommendations in a publication of the Institute are solely those of the author, not of the Institute, its Board or contributors. The Institute maintains neutrality on issues of public policy.

The president bears final responsibility for the decision to disseminate information under the Institute's imprint. He is advised on the accuracy and objectivity of a manuscript by both Institute staff and outside reviewers. Publication of a manuscript signifies that it is deemed to be a competent treatment of a subject worthy of public consideration. Publications of the Institute are in the language of the author, with an executive summary in both official languages.

Rod Dobell, President

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Appendix D

Mexico's Prospects in the Pacific Basin

Sergio Gonzales Galvez[*]

Introduction

It is astonishing to see the changes that have taken place in international relations in the last decade. On the one hand, political tensions among countries have relaxed, while on the other, economic relations have hardened. Previously unalterable political-ideological-strategic blocs are giving way to the formation of trading blocs in Europe, North America and the Pacific Basin.

The succession of events in the Pacific Basin clearly illustrates such changes. President Bush's government now openly talks of the advisability of helping to ensure the success of the policy of perestroika launched by the Soviet leader Mikhail Gorbachev, while penalizing U.S. allies in Southeast Asia by placing them on the "Super 301" list for unfair competition. The Vietnamese and Cambodians have held meetings with representatives from member countries of the Association of Southeast Asian Nations (ASEAN) to establish a *modus vivendi* in Southeast Asia and accelerate economic change. President Gorbachev visited Beijing in May, 1989 and laid down the basis for a Sino-Soviet reconciliation, while South Korea is increasingly opening up to trade with China and the Soviet Union.

Although the outcome of all these events is unpredictable, it is clear that the change towards modernization in the Pacific region is a phenomenon whose effects will have worldwide repercussions. Furthermore, the possibilities of a military conflict breaking out in the South Pacific are diminishing, although economic conflict threatens to escalate, since a formula for cooperation to temper antagonisms in the economic sphere has yet to be found.

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[*] With the collaboration of Victor Kerber.

This article seeks first to examine the reasons behind the transformation of the Pacific Basin into a cardinal focus of world economic stability. This is followed by an overview of efforts to establish a structure for regional cooperation and exchange. Finally, I examine the importance of the Pacific Basin in Mexico's foreign policy and of Mexico's development to the Pacific region.

The Pacific in the World Economy

The systems created by GATT and the IMF provided a framework for post-war economic development and led to increased interdependence between countries, in the sense of a more organic linkage between economies. Moreover, interdependence has been further strengthened in recent years by the rapid globalization of trade, communications, transportation, financial networks and the activities of multinational corporations. But while interdependence has indeed deepened, it has not always been in tune with the principle of equity, which is why some experts view it as complex, asymmetrical and even unattainable in practice.

Greater interdependence implies greater contact between different economic units and, therefore, greater likelihood that conflicts of interests will arise. The dynamics of change occurring in the world are so accelerated that sometimes events overtake expectations in the summit meetings of the world's seven most industrialized countries, and world economic institutions have difficulties adapting to new situations.

Without a doubt, the market of the United States continues to be the most important consumer pole in the world, but the U.S. economy's leading role in trade has been reduced with the appearance of new poles where wealth is concentrated, one of which, Japan, towers above the rest. The economic imbalances that have arisen between Japan and the United States are perhaps the cause of tension that gives rise to the greatest concerns in economic relations between Pacific Basin countries.

The U.S. trade deficit in 1987 amounted to $160.3 billion, which was reduced to $126.5 billion the following year. Over 40 percent ($52.6 billion) of its 1988 deficit was with Japan.

There is intense debate over the consequences of the U.S.-Japan trade imbalance and on ways of solving it. But it is important to point out that the imbalance is one reason that trans-Pacific economic cooperation agreements have not been established and the stability of the economic system as a whole has been endangered.

The United States has persisted in pressuring Japan to open its market to imports of U.S. products and to allocate larger amounts of its resources to military spending and rearmament. The latter would allow the U.S. to reduce expenditures for the defense of Japan. In the Asian region and within Japan, however, there has been firm opposition to rearmament, while the political cost of liberalizing markets for meat and citrus fruits has been reflected in reduced support by the Japanese public for the government.

Nevertheless, there are plans to undertake structural reforms in Japan aimed at stimulating domestic demand, redistributing land ownership and internationalizing the

Japanese public. The 1986 Maekawa Report is a specific proposal for this type of modernization.

Many Japanese observers believe that the economies of Japan and the U.S. are so intrinsically linked that reform efforts in Japan must be compensated for with similar efforts on the American side. The most incisive criticism on the part of Japan is that the United States does not appear to want to do anything in this regard, and is allowing trade and budget deficits to rise irremediably.

In recent years, Japanese investment in the U.S. has also increased due to its foreign exchange surplus resulting partly from trade and partly from the overvaluation of the yen. This investment has become another source of concern in U.S. public opinion, which is hypersensitive to the idea of seeing the United States "absorbed" by Japan.

This wave of U.S.-Japan tension has affected attempts to establish economic cooperation in the Pacific Basin, leading to stagnation in forums such as the Pacific Economic Cooperation Conference (PECC) on the one hand, while accelerating the urgency to find formulas for agreement on the other.

But the economic stability of the Pacific Basin is not only rooted in Japan-U.S. relations, which many consider to be the most important economic relationship in the world. The majority of the countries of East Asia have reached growth levels ranging between five and ten percent as a result of their export-focused industrialization policies. Economic relations in the region can be characterized as interdependent and complex.

The combined exports of the newly industrialized economies (NIEs), the ASEAN and China amounted to 11.2 percent of the world's total in 1987, which was higher than the 10.4 percent registered by the United States and Japan's 9.6 percent. With regard to imports, however, the story is quite different. The combination of Japan, the NIEs, the ASEAN and China accounted for 16.3 percent of the world's total, compared with 17.3 percent for the United States. The U.S. is the main market for practically all the East Asian economies, most of them on favorable terms.

In light of the economic interdependence of the economies in the region, there is a pressing need to institute an economic cooperation system in the Pacific Basin. Although PECC is the most advanced coordination framework for reaching that objective, it is still far from becoming a consolidated agreement along the lines of Europe 1992 or the Free Trade Agreement between the United States and Canada.

Efforts to Create a Cooperation Agency in the Pacific

The goal of instituting an economic cooperation system in the Pacific Basin is now over 20 years old. A Pacific Free Trade Association (PAFTA) was first proposed in the late 1960s by Professor Kiyoshi Kojima of Hitotsubashi University in Japan. Kojima advocated the elimination of tariff barriers between the five most developed countries in the Pacific: the United States, Canada, Australia, New Zealand and Japan.

Due to differences of opinion on the operative factors and advantages of the proposal, PAFTA never materialized. The lack of links between PAFTA and the development processes of the least developed countries in the Pacific was one of the main criticisms of the proposal, since many of them required preferential treatment to overcome the difficulties arising from decolonization. It is likely that Cold War considerations, resulting from experiences in Korea and Indochina, also played a part. That is to say, there was a fear of leaving recently decolonized countries at the mercy of China and the Soviet Union.

Kojima then formulated a new proposal for the Pacific Basin, in the form of the Organization for Pacific Trade and Development (OPTAD). In addition to the five countries in PAFTA, OPTAD also included the island nations of Oceania, certain East Asian economies such as South Korea, Taiwan and Hong Kong, and the Latin American countries bordering the Pacific. OPTAD did not materialize either, since it incurred the mistrust of developing countries, which viewed it as a veiled means of neocolonial subjection and highly disadvantageous to their economies. However, OPTAD at least had the virtue of being a far more comprehensive proposal than PAFTA.

In the first half of the 1970s criticism of OPTAD was perfectly understandable in the midst of the generalized clamor of Third World nationalism, which culminated in 1973 with the OPEC oil embargo and the sharp increase in the price of crude oil. With oil imports of as much as 99 percent of its consumption, Japan was one of the most defenseless victims of that strategy. Its most serious problem was ensuring supplies of crude oil for its industry. In response, Japan began to apply diversification and oil rationing policies and Japanese companies undertook a general restructuring of their industrial bases, transferring abroad plants that were not very competitive, that were labor-intensive and that consumed large amounts of energy and natural resources.

On the basis of a study carried out by the Nomura Research Institute in 1978, the following year Masayoshi Ohira, in one of his first actions as Prime Minister, ordered the establishment of three study groups to help project and give content to Japan's role in the world order. One was responsible for analyzing Japan's economic relations with the remaining countries, another was in charge of examining the concept of "comprehensive national security," and the third was to study the viability of a cooperation agreement in the Pacific Basin. Dr. Saburo Okita was appointed to head the third group and was subsequently named Minister of Foreign Affairs by Ohira.

At the beginning of 1980, Ohira visited some of the countries of the Pacific in order to test the idea of creating a cooperation agency in the Pacific Basin. Ohira's objective was supported by the Australian Prime Minister, Malcolm Fraser, and the idea of creating a Pacific "community" was mentioned for the first time in a joint communiqué. The Australian National University, in turn, pledged to hold a non-governmental seminar to continue analyzing a plan for cooperation in the Pacific region. The Canberra Seminar was based on the OPTAD proposal, with the participation of tripartite committees from each of the countries listed by Kojima, except those of Latin America.

The keen interest in establishing a Pacific community waned shortly after the Canberra Seminar, mainly because of the general skepticism as to the existence of a spirit of "community" between countries as heterogeneous as those in the region. The ASEAN feared that the establishment of another organization would diminish the strength it had acquired as an independent association. It was also suspected that behind the Japanese intentions was a modern version of the Great Sphere of Asiatic Co-prosperity which had served to justify Japan's military expansion in Asia during the 1930s and 1940s.

Conversely, the Soviet Union accused those encouraging the establishment of an economic cooperation agency in the Pacific of secretly seeking to create an anti-Soviet alliance and, therefore, strengthened its military bases in Northeast and Southeast Asia. The United States, once Ronald Reagan became President, opted to reinforce its alliance with NATO countries rather than attend to Asia-Pacific security concerns, where U.S. incursions in the past had proved more harmful than successful. And policy in the People's Republic of China emphasized a program of domestic structural modernization rather than the establishment of multilateral frameworks for agreement in the Pacific.

The Ohira initiative thus came to a halt. The sudden fall of Masayoshi Ohira in the midst of a domestic political upheaval in June 1980 was also a contributing factor. Zenko Suzuki, Ohira's successor, tried to keep the concept of economic cooperation in the Pacific alive out of a sense of duty to his friend and mentor, but he subordinated it to the priority interest of improving relations with the U.S., which was already feeling the burden of the trade deficit and of Japan's refusal to engage in rearmament. In that regard, Suzuki agreed to grant a concession to the U.S. government by pledging to safeguard security in a 1,000 mile radius from the coasts of the Japanese archipelago, which aroused even greater opposition from its neighbors.

In June 1982, in a speech given at the East-West Center in Honolulu, Suzuki tried to show his government's willingness not to break the alliance with the United States and to step up Japan's commitment to Pacific cooperation. On that occasion he listed five principles for action in the Pacific, these being that it should be open, and an ocean of peace, freedom, diversity, and mutual benefits.

At the same time, a second meeting was held in Bangkok to continue the work initiated in Canberra. The seminar series was in the process of becoming the Pacific Economic Cooperation Conference (PECC) which maintained a tripartite structure with individual representatives from member countries from the private, academic and governmental sectors. Another five meetings were held subsequently—Bali (1983), Seoul (1985), Vancouver (1986), Osaka (1988), and Auckland (1989). It became evident at the Osaka meeting that previous skepticism had largely been overcome. The ASEAN countries participated without weakening their structure, the U.S. renewed its interest in the Pacific Basin, and China participated as a full member, even with the presence of Taiwan. The Soviet Union, in an unusual turn of events, requested to become a full member of the Conference, and several Latin American countries, Mexico among them, attended as observers.

Although many of the previous differences have been solved, new problems arose in PECC which could make it lapse into stagnation if they remain unsolved. For instance, some businesspeople refuse to allow governments to play a part because they feel that would only serve to create another multilateral organization that would eventually become mired in bureaucracy. Conversely, discussions have arisen as to how much PECC can influence the establishment of economic cooperation frameworks if governments have yet to make a commitment and if heterogeneity continues to be an obstacle. In addition, there are those who think that in view of the lack of definition of what should constitute the Pacific region and for political rather than economic reasons, it would not be advisable to extend membership to other Latin American countries and the Soviet Union.

Prospects for Mexico

The government of President Carlos Salinas de Gortari has shown interest in cultivating better relations with the countries of the Pacific Basin. During his visit to Tokyo in June 1990, President Salinas declared to a group of distinguished members of the private and public sectors in Japan that events in the Pacific affected Mexico and that Mexico therefore needed to become part of the wave of modernization sweeping the Pacific region. He then listed four structural changes that were necessary for any country wishing to be at the forefront of the community of nations: 1) it must take advantage of the world technological revolution; 2) it must increase exports to world markets; 3) it must reduce unemployment; and 4) it must decentralize its activities.

These four points had been included in the 1988-1994 National Development Plan (NDP), in which the Pacific Basin is correctly viewed as *one* of the geographical areas that call for greater diplomatic, economic and cultural presence on Mexico's part, but not as the *sole* answer to our problems. It is important to bear this in mind, since some observers tend to look upon the Pacific Basin as a short-term panacea.

The approach that should be taken to the Pacific Basin is that this is simply a zone of "growing opportunities," as it is described in the NDP, and should form part of a strategy of multidirectional diversification, the bases of which are contained in the Plan. The rationale behind this premise is that Mexico holds a privileged location in the world of which greater advantage must be taken by paying greater, more balanced attention to different regions.

Mexico's position with regard to the plans for economic cooperation being discussed in the Pacific Basin is that it should be based on the OPTAD formula conceived by Professor Kojima and subsequently developed by the working group headed by Saburo Okita. Unfortunately, developments in PECC lean towards a limited organization, more in the nature of a sectarian club. This was pointed out by former Prime Minister Yasuhiro Nakasone in his address at the Osaka Conference. Nakasone requested at that time that development schemes in the Pacific Basin should be reconsidered bearing in mind: 1) a macroscopic, long-term perspective; 2) open, non-exclusive forms of cooperation; and 3) cooperation projects in keeping with the spirit of the United Nations Charter.

The Mexican delegation at PECC meetings, therefore, opted to maintain its observer status until conditions for requesting full membership were made clearer. Mexico has nevertheless sought to participate actively in the various working groups that form the operational organ of PECC. Mexico believed that it would not be beneficial to withdraw from the Conference in that it continued to be the structure in which progress towards a more favorable political and economic situation was being discussed in the most feasible terms. Finally, in September of this year, the PECC Standing Committee decided to recommend Mexico's request to become a full member of the Conference together with Chile, Peru, and Hong Kong, a development that might inject new strength into Pacific economic cooperation.

President Salinas de Gortari's statement that Mexico should commit itself to becoming part of all economic blocs should thus be interpreted as a rejection of a world order based on separate units. Mexico believes it can channel its participation in world development in a multidirectional, rather than a unidirectional manner. The Pacific Basin is but one of the borders that surrounds Mexico and perhaps that which has been made least use of to benefit the country.

The Mexican Pacific Basin Commission provides a necessary mechanism for analysis and discussion, enabling Mexico to gain understanding of the Pacific Basin and establish closer links with it. The Commission is made up of representatives of the academic, private and public sectors and its fundamental purpose is to examine the unfolding events in the Pacific in order to gradually incorporate Mexico into projects for cooperation in the region, such as exchanges of advanced technology, capital and human resource flows, rationalization of energy sources, and development of telecommunications systems.

Mexico's activities in the Pacific are focused on a comprehensive, long-term approach aimed at increasing our country's presence in a region that the famous historian Lucas Alaman had already viewed as being decisive to Mexico's development. There is, therefore, an urgent need to establish a greater presence of Mexico and of Mexican culture on the Asian Rim of the Pacific. The Foreign Relations Secretariat has already taken measures in this regard, by reinforcing its embassies in Tokyo, Seoul, Beijing, and Melbourne; broadening the faculties of the General Consulate in Hong Kong; and opening new embassies in Bangkok and Singapore.

Moreover, Mexican participation in the specialized Pacific forums is now frequent and the number of Mexican students wishing to enrich their knowledge by studying in academic institutions in Asian countries has increased. Japanese, Korean and Taiwanese investment in Mexico has multiplied during the past few years and trade with the Far East is on the rise. There is, without a doubt, full recognition of the importance of the Pacific Basin for Mexico. Nevertheless, there is a need to show that Mexico is important to the interdependent economies in the Pacific. It is a task that requires a combination of patience and urgency.

Appendix E

The First New Era Summit

Kenneth S. Courtis

In Paris in 1989, their agenda was so light that Summit participants went home half a day early. In contrast, so important were the issues they faced at the 1990 Houston Summit, that time almost ran out on them. What a difference a year makes. The difference is that in the interval, the world's economic and political systems have entered the most complex and important period of transition in half a century.

The effect of the movement for reform sweeping across Eastern Europe has broken the iron grip of the Cold War which for so long polarized and distorted the ebb and flow of international relations. Indeed, change has progressed so far that NATO leaders have declared the Cold War over. One of the immediate consequences of the reduction in superpower tensions accompanying this new era is that international relations are becoming increasingly driven by national interest.

A New Style and Character

The challenge that Summit leaders faced in Houston was as much in the balancing of their own particular interests with those that they share collectively, as it was in addressing the issues that are now at the top of the international agenda. Deeply divided on arriving in Houston, by the end of their meetings, the Summit seven had reached working compromises on the main issues, without compromising what was to each essential. They agreed where they could, and where they could not, they agreed to disagree. The style and tone of the meeting was new, and it will become increasingly the mark of G-7 meetings in the future.

The new era context, and the still shifting balance of international economic and financial power among G-7 countries themselves, also gave to the Houston Summit a different character than that of previous Summits. In expressing themselves with increased confidence and weight, Germany and Japan have begun to play new, pivotal roles in the meetings. The new balance of power emerging at the core of the G-7 will increasingly mark the character of Summit meetings. Certainly it was the key to the three critical issues addressed in Houston.

The Soviet Union

Glasnost has released enormously powerful forces for change in Soviet society, but perestroika has yet to bear fruit. The building gap between expectation and promise could lead, and much more quickly than is widely understood, to such widespread social disruption that the Soviet Union could be driven to a brutal reversal of course. The paramount issue that the G-7 now faces is how best to support a continuing positive transition in the Soviet Union. Three different and seemingly irreconcilable views emerged in pre-Summit discussions.

Germany, France and Italy are committed to a $15 billion immediate assistance program for the Soviet Union. While no small amount of money, the view among these frontline states is that such a package, at this critical juncture, is a small price to pay for assisting the current leadership of the Soviet Union to strengthen its position and to agree to the next phase in the transition of Eastern Europe.

On his recent mission to Moscow, West German Chancellor Kohl carried details of an assistance package that included funds for food, transportation and management assistance. Additionally, West Germany is about to take the lead in arranging large scale contracts for the purchase of energy and other resources from the Soviet Union.

The Anglo-American Summit participants expressed their support in principle for a new initiative, but believe that the Soviet Union has yet to set in place structures that would allow it to absorb fully such funds in a positive manner. They also argue that in exchange for the funds, the Soviet Union should not only accept that a unified Germany be part of NATO, but also that the U.S.S.R. should make further commitments to reduce defense spending at home and abroad.

It would be unrealistic to expect the Soviet Union to accede to such conditions immediately. At the same time, with congressional elections in the offing, already risking Republican conservative wrath because of his flip-flop on taxes, and facing a massive budget crisis, President Bush has at the moment very little margin of maneuver on the question. By proposing that the International Monetary Fund (IMF) take six months to prepare a comprehensive aid program for the Soviet Union, the American administration positions itself to influence the study directly, to build political support for its recommendations in Congress, and to bring Japan, by virtue of its membership in the IMF, into the process.

Throughout the Summit, Japan maintained a clearly different view. The base price it has set for aid for the Soviet Union is return of the disputed Northern territories. The final communiqué expressed understanding of Japan's position, but with the clear expectation that progress be made on the issue in the run-up to the Soviet-Japanese summit next year.

To make a real difference, G-7 assistance to the Soviet Union must be at least as ambitious as was the Marshall Plan four decades ago. With the three phase approach adopted in Houston, a process is now in place to move in that direction. EC aid will come immediately. By the end of the year, a consensus will have emerged about the main elements of a larger and more comprehensive package. That will prepare the stage for the Gorbachev visit to Tokyo in early 1991, when the last piece will be set to fall into place, which will allow Japan to join the movement.

The Uruguay Round

Were it successful, the Uruguay Round of multilateral trade negotiations would have an enormously positive impact for the global economy. But the talks are now in deadlock. If the deadlock is not broken there is a very real potential that the global trading system will be fundamentally disrupted. The principle point of contention is agriculture, and it is one that pits Europe and the United States directly against each other.

Although in the Houston declaration, Summit leaders reaffirmed their determination for a successful conclusion of the Uruguay Round and stressed their "commitment to the long-term objective of reform" toward market-driven agricultural policies, the final communiqué contains no specifics. The closest it comes is to state that each participant would be required to make "substantial, progressive reductions in support and protection of agriculture." Indeed, in a new twist, and another indication of Tokyo's growing influence on the Summit process, the Houston declaration accepted the Japanese position on the need to integrate the principle of "food security" into the Uruguay talks.

In the OECD alone, the cost of export supports, subsidies, import protection, and fiscal favors to agriculture, amount to almost a quarter of a trillion dollars a year. Although each G-7 participant needs to make difficult decisions, it is the European Community that has most to move. Largely financed by Germany, the Community Agricultural Policy and related regional development programs are at the base of the many political compromises on which support has been built throughout the EC for the move to a single market. It is for this reason that it will take an enormous act of statesmanship for Europe to move ahead on this issue.

With the clock ticking on the deadline just six months away, and literally hundreds of issues remaining to be resolved, it is unlikely that the Uruguay Round will fulfill its promise. The Summit has served to raise the sense of urgency. But much more is required. To avoid a complete impasse, it will probably be necessary to invoke the special extension clause that will allow the negotiations to be extended to the end of 1993.

China

Although at the Paris Summit, which was held in the immediate wake of last year's events in Beijing, participants decided to suspend all credits and high level missions to China, the suspension has already begun to unravel. The World Bank has granted four "humanitarian" loans in recent months, the United States recently restored Most Favoured Nation status to China, and it is almost impossible to keep track of the high level missions visiting Beijing.

Under enormous pressure from business, and more keenly aware than ever of its own particular geopolitical position, Japan argued strongly for restoring normal relations with China. The European Community disagrees, but did not oppose Japan's initiative, which the United States accepted. Britain offered solid support for Japan with the hope that normalization will be a plus for Hong Kong as it enters the countdown to 1997.

At the very moment that Prime Minister Kaifu was putting the case for Beijing, a blue ribbon panel of very senior Japanese business leaders was visiting China to study business opportunities. Although Japan will move at first gingerly, it will announce very soon a partial release of the 810 billion yen in subsidized credits previously authorized for China. Were Japan to work successfully at the same time for a relaxation of political oppression in China and a renewal of the reform process, the initiative would later be seen as a major turning point. Playing with exquisite skill his international hand, Prime Minister Kaifu could further demonstrate leadership on this issue were he to go to Beijing to put the issue directly to China's leadership.

The Course Ahead

Houston was the first post-Cold War Summit, and never have summiteers faced higher stakes. The seven delegations presented us with a brilliant display of that high political art of compromise. But as a result, no issue was resolved cleanly. Yet Houston does provide a base from which to build progress. To do so, however, will require creative and courageous leadership. More than anything else, it is that challenge of leadership which has become the critical issue for the course ahead. Increasingly, others will expect Japan to help lead the way.

Appendix F

Meeting on Energy and Environment
Sponsored by The North American Institute (NAMI)
Oaxtepec, Mexico
December 8-10, 1989

Agreed Statement of Participants

Our discussions were based on mutual recognition of the growing economic and social interdependence among our three North American countries and of the need to foster continued development of mutually beneficial relations as a matter of high priority.

We discussed the energy and environmental outlooks of Canada, Mexico and the United States, the links between energy and environmental issues, and the issue of sustainable economic and social development for each of our countries and for the North American region as a whole.

We concluded that each of our governments, in formulating its national energy and environmental policies, should consult regularly with the other governments on a trinational basis.

To that end, we recommend that the Heads of Government of Canada, Mexico and the United States establish a Trinational Consultative Commission on North American Energy and Environment.

The following is a summary of our conclusions and recommendation.

Conclusions

- Energy plays a vital, pervasive role in the economic and social development of Canada, Mexico and the United States. Insufficient energy supplies would severely constrain future opportunities for development and growth in each of the countries. Fortunately, the North American continent is richly endowed with oil, gas, coal, uranium, and renewable energy resources.

- The development, production and consumption of energy are major sources of environmental pollution. Urban smog, acid rain, and global warming are major consequences of hydro-carbon combustion, while long-lived radioactive waste results from nuclear fission. The environmental consequences of energy-related activities are not confined within national boundaries, but are regional and global concerns.

- The energy sectors of the economies of Canada, Mexico and the United States are interdependent. In particular, the United States imports large amounts of oil from Mexico, and large amounts of oil and natural gas, and significant amounts of electricity from Canada. Inefficiencies in the energy performance of the United States, leading to excessive reliance on imported oil are an increasing concern of Canada and Mexico. The continued availability of oil exports from Mexico and oil and natural gas exports from Canada, among others, will be a continuing concern of the United States.

- The countries of North America should focus future development of their energy infrastructures on ways which are sustainable over the long-term in light of existing and emerging environmental constraints. To accomplish this:

  - Energy prices should reflect full costs, including costs of consequential damage to the environment. Gaps between prices based on full costs and current market prices should be closed through charging user fees or consumption taxes, with the proceeds used to support desirable technology development and to provide transition adjustments for adversely affected industries, as well as to clean up past environmental damage.

  - The energy market should be open, subject to each country providing for its energy supplies from domestic production. Competitive market forces should be used as a primary means to assure that energy resources are developed and used in timely and efficient ways.

  - Measures to enhance efficiency of energy use and conserve energy resources, and on the development of advanced technologies to make use of solar, nuclear and other non-fossil energy resources should receive a high priority.

  - Canada and the United States, as industrially advanced countries, can afford to allocate more resources to environmental protection than Mexico, for which economic development remains the more immediate imperative. Nevertheless, the environmental problems Mexico faces are enormous. If the three countries which share the North American continent can find collaborative solutions for environmental problems of the North American region, their success could serve as a model for development of solutions to wider North-South issues regarding environment and development.

- Canada, Mexico and the United States should consult regularly on a trinational basis, regarding the formulation and implementation of their respective national policies on energy development and use and environmental protection. This conclusion is based not only on the intrinsic requirements for effective energy and environmental policies, but also on our geographical proximity on a shared continent and the growing interdependence of our economies as a whole.

Recommendation

We recommend that the Heads of the Governments of Canada, Mexico and the United States establish a trinational Consultative Commission on North American Energy and Environment, in order to assess common problems and seek collaborative solutions. The Commission would have the following purposes, composition and duration.

Purposes

The purposes of the Consultative Commission would be:

- To evaluate, from the viewpoint of the North American region, the energy and environmental situations, trends and policies of Canada, Mexico and the United States.

- To recommend to the governments of the three principal North American countries, actions, policies and institutional arrangements that will enhance cooperation and policy coordination among them in their future development and use of energy resources and technologies, and in their future development and implementation of measures to protect the environment of the North American continent.

Composition

The Consultative Commission would be composed as follows:

- The heads of the respective energy ministries or departments and the heads of the respective environmental ministries or departments of the governments of the three countries.

- The chairmen of the parliamentary or congressional committees with leading legislative responsibilities for energy and environmental matters.

- A limited number of additional members appointed by the heads of government to represent their respective energy industries and non-governmental environmental organizations.

- A small trinational secretariat of experts seconded temporarily by the three governments.

Duration

The Commission would be established for a period of five years. The existence of the Commission could be continued for additional five-year periods upon the affirmative decision of the three governments. After the initial five-year period, the three governments would consider whether additional countries should be invited to join the Commission.

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